Supreme Court, U.S.
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No. 01-695

In The

Supreme Court of the United States

IRWIN MORTGAGE CORPORATION,

Petitioner,

v.

JOHN ROBERT CULPEPPER, PATRICIA STARNES CULPEPPER, ON BEHALF OF THEMSELVES AND ALL OTHERS SIMILARLY SITUATED, AND BEATRICE N. HIERS, INDIVIDUALLY AND AS A REPRESENTATIVE OF A CLASS OF SIMILARLY SITUATED INDIVIDUALS,

Respondents.

On Petition For Writ Of Certiorari To The United States Court Of Appeals For The Eleventh Circuit

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CORPORATE DISCLOSURE STATEMENT

Irwin Mortgage Corporation is an Indiana corporation and a wholly-owned subsidiary of IFC Mortgage Corporation. IFC Mortgage Corporation is a wholly-owned subsidiary of Irwin Financial Corporation, a public corporation.

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COUNTER STATEMENT OF THE CASE

It is the standard practice of Irwin Mortgage Corporation, the Petitioner, to pay "yield spread premium fees" (YSPs) directly to mortgage brokers as an inducement for such brokers to refer "above-par" (*i.e.*, high interest rate) mortgage loans to Irwin for funding and servicing. The higher the interest rate obtained by a mortgage broker, the higher the YSP Irwin proposes in its daily rate sheets to pay the broker for the referral of the loan. Irwin's YSPs are calculated as a percentage of the loan amount without regard to the amount or type of work the broker may perform for the borrower and without regard to whether the mortgage broker is owed any additional compensation for his loan origination services. The Plaintiffs/Respondents contend that Irwin's payment of YSPs for the referral of above-par mortgage loans constitutes the payment of "referral fees" prohibited by § 8(a) of the Real Estate Settlement Procedures Act (RESPA), 12 U.S.C. § 2607(a). The Eleventh Circuit has agreed with the Plaintiffs in two interlocutory appeals, and its decisions are not in conflict with any other court of appeals.

BACKGROUND

In 1974, Congress enacted RESPA to eliminate "kickbacks or referral fees that tend to increase unnecessarily the costs of certain settlement services" in the real estate settlement process. 12 U.S.C. § 2601(b)(2), Res. App. 48a. Consistent with this purpose, Congress enacted § 8(a) of RESPA, which provides that:

> (a) **Business referrals**
>
> No person shall give and no person shall accept any fee, kickback, or thing of value pursuant to any agreement or understanding, oral or otherwise, that business incident to or a part of a real estate settlement service involving a federally related mortgage loan shall be referred to any person.

12 U.S.C. § 2607(a). Persons who violate this statutory prohibition on referral fees can face up to one year in prison, a fine of $10,000 and civil liability for three times the amount of the referral fee. § 8(d), 12 U.S.C. § 2607(d), Res. App. 49a.

Section 8(c) provides a narrow list of payments that are excluded from § 8(a) and (b) liability. Specifically, § 8(c)(2) exempts any "payment to any person of a bona fide salary or compensation or other payment for goods or facilities actually furnished or for services actually performed." 12 U.S.C. § 2607(c)(2). Congress also granted HUD the limited authority to issue formal "regulations" which exempt "other payments or classes of payments" from § 8(a) liability "after consultation with the Attorney General, the Administrator of Veterans' Affairs, the Federal Home Loan Bank Board, the Federal Deposit Insurance Corporation, the Board of Governors of the Federal Reserve System, and the Secretary of Agriculture." § 8(c)(5), 12 U.S.C. § 2607(c)(5), Pet. App. 69a.[1] HUD has never availed itself of the authority granted in § 8(c)(5) to

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[1] Congress also provided a general grant of authority to HUD to make certain interpretations, rules and regulations "as may be necessary to achieve the purposes of this chapter." 12 U.S.C. § 2617(a). Congress did not, as Irwin states, grant HUD *carte blanche* authority to "implement RESPA." Pet. at 4.

craft new exemptions from liability, nor has it otherwise issued notice-and-comment regulations regarding § 8(c)(5).

PROCEDURAL HISTORY

The Plaintiffs filed this case on April 11, 1996, alleging that Irwin's YSPs constitute unlawful referral fees in violation of § 8(a), 12 U.S.C. § 2607(a). On November 26, 1996, Irwin filed a motion for summary judgment, arguing that its YSPs were payments for goods (that is, the loan package) and thus, were exempt from § 8(a) liability by reason of § 8(c)(2). Pet. App. 51a. Irwin also argued that since its YSPs were purportedly "reasonable" in amount, they were not illegal. *Id.* at 59a. The district court granted Irwin's motion, and the Plaintiffs appealed to the Eleventh Circuit. *Id.* at 60a.

Culpepper I

On appeal, the Eleventh Circuit "tracked" the language of § 8(a) and set forth the applicable test for § 8(a) liability, holding that "RESPA is violated if (1) a payment of a thing of value is (2) made pursuant to an agreement to refer settlement business and (3) a referral actually occurs." *Id.* at 42a. Applying this statutory test to Irwin's practices, the court concluded that the "undisputed facts compel the conclusion that Inland's payment of the yield spread premium to [the Plaintiffs' mortgage broker] was a referral fee [not payment for goods or services], and thus a violation of RESPA . . . ," and reversed the court's

entry of summary judgment. *Id.* at 42a, 46a.[2] The court also rejected Irwin's claim that the legality of its YSPs turned on the "reasonableness" of the broker's compensation as a whole. *Id.* at 45a ("The market value test is useful only if the payment is for a good or service in the first instance and a determination must be made whether the payment is so excessive that the excess should be characterized as a referral fee.").

Culpepper II

Irwin petitioned the Eleventh Circuit for a rehearing and rehearing *en banc*, arguing that the circuit court had, in effect, inappropriately granted summary judgment in the Plaintiffs' favor, even though the Plaintiffs had not yet moved for summary judgment in the district court. Pet. App. 49a. The Eleventh Circuit denied Irwin's petition, but clarified that Irwin could try on remand to prove that its YSPs were not referral fees. *Id.*[3]

HUD's 1999 policy statement

Following *Culpepper I*, the mortgage industry put intense political pressure on Congress to impose a moratorium on RESPA class actions. Congress refused. *See*

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[2] *See also id.* at 46a ("Under the particular facts here, the yield spread premium Inland paid to Premiere was a prohibited referral fee under RESPA.") ("The yield spread premium payment thus violated RESPA.").

[3] The court noted, "[n]onetheless, . . . that certain facts about the nature of this financial transaction seem to be undisputed which, at a minimum, presents a hurdle for Inland at trial." *Id.*

Real Estate Settlement Procedures Act Class Action Relief Act of 1997, H.R. 1283, 105th Cong. § 2; Mortgage Litigation Reform Act of 1998, S. 2223, 105th Cong. § 2, Res. App. 42a-47a. However, a House of Representatives conference report on the 1999 Appropriations Bill directed HUD to issue a policy statement setting forth its position on the legality of YSPs. *Id.* at 74a. In compliance with the dictates of the report, on March 1, 1999, HUD issued its 1999 policy statement within the required 90 days after consulting with consumer organizations, the mortgage industry, and various government organizations. *Id.* at 76a, 91a. Consistent with *Culpepper I*, the 1999 policy statement set forth a two-part test for determining the legality of YSPs: (1) "whether goods or facilities were actually furnished or services were actually performed *for the compensation paid*"; and (2) "whether the payments are reasonably related to the value of the goods or facilities that were actually furnished or services that were actually performed." *Id.* at 93a (emphasis added).

The first prong of HUD's 1999 policy statement test tracks the language of § 8(c)(2), which exempts from liability compensation and similar payments made "***for*** goods or facilities actually furnished" or "***for*** services actually performed." 12 U.S.C. § 2607(c)(2) (emphasis added). The second prong adds that even where a payment is actually paid for a bona fide good or service, such as for a credit report or appraisal, it may nevertheless be scrutinized to insure that the payment was not inflated for the purpose of inducing a referral.[4] HUD's General

[4] The second prong of the 1999 policy statement test is consistent with HUD's regulation X which provides that HUD

Counsel further explained the 1999 policy statement analysis as follows:

> HUD's position is that for a payment from a lender to a mortgage broker to be permissible under RESPA: (1) goods or facilities must have been furnished or services must have been performed **"for" – i.e., in exchange for** – the compensation paid to the broker. . . . The Policy Statement then provides that "[t]he fact that goods or facilities have been actually furnished or that services have been actually performed by the mortgage broker . . . does not by itself make a payment by a lender to a mortgage broker legal." 64 Fed. Reg. 10085-86. Accordingly, **the mere performance of any service by a mortgage broker is not in itself sufficient to establish that the payment to the broker was made in exchange for those services.**

See HUD's General Counsel Opinion Letters to Senator Shelby and Congressman Vento, Res. App. 51a-58a (emphasis added).

Culpepper III

On February 25, 1999, the Plaintiffs moved the court to certify a class of borrowers pursuant to Fed. R. Civ. P. 23(b)(3). *Id.* at 11a. Irwin argued (as it does here – Pet. at 6) that the 1999 policy statement required only proof that

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"may investigate high prices to see if they are the result of a referral fee or a split of a fee. If the payment of a thing of value bears no reasonable relationship to the market value of the goods or services provided, then the excess is not for services or goods actually performed or provided." 24 C.F.R. § 3500.14(g)(2) (emphasis added).

any service had been performed and that the court then would be required to determine the reasonableness of the broker's total compensation in each mortgage transaction to be able to determine § 8(a) liability without regard to whether the payments were made in exchange for the broker's services. *Id.* at 23a. Irwin contended that its "reasonableness of total compensation" test for liability created overwhelming individual issues, thereby preventing class certification. *Id.* Plaintiffs countered that Irwin's "reasonableness of total compensation" test finds no support in the statute or legislative history. Plaintiffs argued that to pass muster under the first prong of the 1999 policy statement test and to be consistent with the clear terms of § 8 and the Eleventh Circuit's earlier decision in *Culpepper I*, the YSP must be paid "in exchange for" the broker's services. The district court agreed and certified the Plaintiffs' class. *Id.* at 24a, 27a.[5] The district court issued a subsequent opinion on July 20, 1999, clarifying that HUD's 1999 policy statement did not undercut, and in fact supported, its determination that certification of the case was proper. *Id.* at 30a, 32a-35a.

Irwin petitioned the Eleventh Circuit to permit an interlocutory appeal of the district court's class certification order pursuant to Rule 23(f), which the Eleventh Circuit granted on September 29, 1999. *Id.* at 3a. The

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[5] The district court did not base its class certification decision, as Irwin suggests, solely on the basis of how YSPs are calculated. On the contrary, the court's central focus was on the fact that Irwin had been incapable of showing that its "yield spread premium is tied in some fashion to the services provided it by the broker." Pet. App. 26a.

circuit court found that in order to determine the propriety of class certification, the "crux of the appeal" would be to determine the applicable standard of liability under § 8(a). The circuit court focused its attention on the plain language of the statute and found that HUD's 1999 policy statement's two-part test was consistent with the statute and the court's earlier statutory analysis set forth in *Culpepper I*. *Id.* at 10a. The circuit court rejected Irwin's proposed "reasonableness of total compensation" test, however, as inconsistent with the statute. *Id.* at 10a ("Irwin's reading of the Statement is not only inconsistent with the Statement itself; it also would make the Statement clash with § 8(c)'s language.") ("The statute itself thus implies very strongly that only payments whose reason is compensation for services fall within § 8(c)'s safe harbor. . . . "); *see also id.* at 11a ("we should avoid reading § 8(c) to bless conduct that § 8(a) plainly outlaws.").

The circuit court then determined that the Plaintiffs' proof that Irwin's general practice of paying YSPs is illegal under § 8(a)–that is, "the terms and conditions under which a lender pays the broker a yield spread premium"–is subject to class-wide evidence. *Id.* at 14a. On June 15, 2001, the Eleventh Circuit affirmed certification of the class. *Id.*[6] Irwin petitioned the Eleventh Circuit

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[6] Irwin claims that its YSPs are beneficial to homeowners, allowing them to finance closing costs, and that *Culpepper III* renders all YSPs illegal (Pet. at 2, 13). On the contrary, the Eleventh Circuit in both *Culpepper II* and *III* explained that it was not holding YSPs illegal per se. Rather, the circuit court simply required evidence that YSPs are used to reduce closing costs to borrowers for services that were actually performed,

for rehearing and rehearing *en banc*, which the circuit court denied on August 15, 2001. *Id.* at 67a.

HUD's 2001 policy statement

Since Congress had earlier refused to do their bidding,[7] the mortgage industry lobbyists prevailed upon the new HUD administration to issue a new policy statement. The Mortgage Bankers Association drafted a proposed "clarification" of the 1999 policy statement, which was incorporated by HUD into its 2001 policy statement. Res. App. 1a-41a.

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which Irwin claims is the purpose of its YSPs. Pet. App. 12a, 48a-49a. The problem, as recognized by the circuit court, is that Irwin has not produced any evidence that its YSPs are used to finance borrowers' closing costs. Indeed, Irwin has not produced one class members' HUD-1 Settlement Statement showing that the borrower received a credit on line 200 under the section "paid on behalf of the borrower" against his closing costs in exchange for Irwin's payment of a YSP. Irwin's argument that YSPs are used to reduce closing costs while inventive, is completely unsupported by the record.

[7] *See* Lenders Ask HUD to Clarify Legality of Yield Spread Premiums, Collections World (July 12, 2001), Res. App. 59a-61a. In this article, the Mortgage Bankers Association admitted that "[g]etting Congress to act would not be easy." In fact, "[s]everal industry officials noted that getting legislative relief would be nearly impossible and it would take too long to be effective." The article further notes that "HUD has been very responsive," and that the industry is "confident, based on the new administration and the people appointed, that they are going to be responsive to this problem."

On October 18, 2001, HUD issued its 2001 policy statement, purporting to "clarify" the 1999 policy statement and setting forth the new administration's disagreements with the Eleventh Circuit's prior *Culpepper III* decision. *Id.* at 107a. The 2001 policy statement adopts the same "reasonableness of total compensation" test that the Eleventh Circuit has twice rejected as irrational and inconsistent with the plain language of the statute. *Id.* at 119a-121a.[8]

The case is currently on remand to the district court. After issuance of the 2001 policy statement, the district court requested briefs from the parties regarding what, if any, deference it should give the 2001 policy statement and inquiring whether it is bound by the "law of the case" doctrine. Pet. App. 63a. The parties have fully briefed these issues and are awaiting a decision by the trial court.

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[8] Irwin's suggestion that the 2001 policy statement was issued pursuant to a congressional delegation of authority (Pet. at 12) to HUD is unsupported. The 1999 policy statement, of which the 2001 policy statement purports to be a "clarification," was issued at the directive of a House conference report and accordingly lacks the force of law. *See, e.g., EEOC v. Metropolitan Educational Enterprises, Inc.*, 60 F.3d 1225, 1228-29 (7th Cir. 1995), *rev'd on other grounds*, 519 U.S. 202 (1997); *In re North*, 50 F.3d 42, 46 (D.C. Cir. 1995). Moreover, the 2001 policy statement does not comply with the dictates of that report, which required HUD to issue its policy statement within 90 days and to seek comment from federal agencies, consumer and industry groups and other interested parties before issuing the statement. H.R. Conf. Rep. No. 105-769, 105th Cong., 2d Sess. at 260 (1999).

STATEMENT OF FACTS[9]

Irwin is one of several mortgage lenders competing for the business of originating, financing, selling and servicing residential mortgages. Vol. I, Doc. 49 at 7.[10] Irwin originates mortgages both through branch offices staffed by its employees (its "retail" division) and

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[9] Irwin's petition contains several misrepresentations of the record. An accurate statement of the undisputed facts and evidence on record is given in the Eleventh Circuit's *Culpepper I* and *III* opinions. *See* Pet. App. at 2a-4a, 38a. The circuit court recapped those facts in *Culpepper III*, explaining:

> The "yield spread premiums" at issue in this case, as the panel explained more fully in *Culpepper I*, are payments from Irwin to its mortgage brokers that the written agreement between them contemplates, but does not define. Each business day, Irwin distributes a rate sheet to its brokers, listing the terms of the loans Irwin is offering that day. The loans' interest rates are set with reference to a "par rate." If the broker originates a loan at a below-par rate, it gets no compensation from Irwin. On the other hand, originating a loan at an above-par rate garners the broker a yield spread premium, whose amount is determined by a formula that includes the amount of the loan and the difference between the loan rate and the par rate. The formula does not take into account the amount of work the broker actually performed in originating the loan or how much the borrower paid in fees for the broker's services. . . . Those facts satisfy § 8(a), the panel concluded. That § 8(a) conclusion remains unchallenged on this appeal.

Id. at 4a.

[10] All record cites are to the district court for the Northern District of Alabama.

through its use of mortgage brokers (its "wholesale" division). Vol. I, Doc. 49 at 6-7. Mortgage brokers are independent businesses which originate mortgages on behalf of various lenders. Vol. I, Doc. 49 at 15; Vol. I, Doc. 52 at 13.[11] While the loan officers in its "retail" operation originate mortgages exclusively for Irwin, Irwin must compete with other lenders to obtain referrals of business from its broker network, since each broker typically originates mortgages for numerous lenders. Vol. I, Doc. 50 at 21-22.

Each business day, Irwin and other lenders fax to this network a rate sheet reflecting a variety of interest rates for each type of loan that they will make to qualified borrowers. Pet. App. at 3a, 38a. A given interest rate for a particular loan is said to be either a "par," an "above par," or a "below par" rate. *Id.* at 38a. By definition, the par rate "is the lowest interest rate at which Irwin will make loans without charging the borrower 'discount points.' " *Id.* at 38a. If a mortgage broker refers Irwin a loan at a below par rate, Irwin requires the borrower to pay "discount points" for the loan. *Id.* If the broker refers Irwin a loan with interest at an above par rate, Irwin pays a YSP directly to the broker. *Id.* at 3a, 38a.

Irwin's method of determining its YSPs is "not tied to services, but to the size and interest rate" of the Plaintiffs' and Class Members' loans. Pet. App. at 3a, 39a. Irwin's rate sheets demonstrate how the amount of the YSP is

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[11] Plaintiffs object to Irwin's insinuation that mortgage brokers provide facilities and goods in exchange for the payment of YSPs (Pet. at 3). There is no evidence in the record that ties Irwin's payments of YSPs to anything but the referral of valuable business.

"solely a function of the extent to which the interest rate on the loan exceed[s] Inland's par rate." *Id.* at 39a. Irwin calculates YSPs based on the prices it expects to receive for the mortgage when it sells the loan on the secondary market and on economic factors, such as market volatility and competition with other lenders for referrals. Vol. I, Doc. 51 at 17, 21 and Doc. 50 at 42. Irwin's decision whether to pay a YSP is totally divorced from the question whether the broker is owed any additional compensation for its services. Irwin pays YSPs without regard to the amount of work performed by the broker in originating the mortgage and regardless of the amount of loan origination fee charged by the broker. Pet. App. at 3a-4a, 44a. Irwin uses YSPs as nothing more than incentives to brokers to steer mortgage loans to Irwin. Vol. I, Doc. 50 at 42 and Doc. 52 at 13. These rate sheets are not considered public information and are not shown to the borrowers. Irwin's brokers, not the borrowers, select the interest rates for each loan, contrary to Irwin's contention at page 4 of its petition. Vol. I, Doc. 52 at 14, 75-76.[12]

On October 30, 1995, John and Patricia Culpepper met with Nancy Blankensopp at Premiere Mortgage Company ("Premiere") to discuss financing for the Culpeppers' purchase of a new home. Vol. 4, Doc. 62 at 29. From Irwin's rate sheet, Ms. Blankensopp selected an interest rate of 7.5% on a thirty-year loan of $77,761.00 for the

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[12] Irwin's contention that borrowers are always aware of the payment of YSPs (Pet. 8) is unsupported. Upon reviewing thousands of loan files at Irwin's headquarters, the undersigned counsel found that it was not uncommon for the YSP not to be listed on any of the closing documents given to the borrower.

Culpeppers. Pet. App. at 38a. Unbeknownst to the Culpeppers, 7.5% was an above par interest rate for their loan. *Id.* at 38a. In actuality, Irwin would have made the same loan to the Culpeppers at an interest rate of approximately 7.25%. *Id.* When the Culpeppers' loan closed on December 15, 1995, they paid Premiere an origination fee of $760.50 (1% of the loan amount) for Premiere's assistance in obtaining and closing their loan. *Id.* Irwin paid the broker a $1,263.61 YSP (1⅝%) for referring it an above par interest rate loan.[13] *Id.*

Ms. Hiers, the other class representative, also originated an FHA mortgage from Irwin with the assistance of a broker, Homebuyers Mortgage Company ("Homebuyers"). Vol. I, Doc. 50 at 19. Homebuyers secured for her a 7% Adjustable Rate Mortgage (ARM) on her $159,750 mortgage. *Id.* at 35-56. Unbeknownst to Ms. Hiers, the 7% ARM was an above par interest rate loan for which Homebuyers received a substantial YSP, in addition to the other payments made in connection with the origination of the loan. Vol. I, Doc. 48 at J. Homebuyers was paid the FHA maximum 1% origination fee ($1,544.00) plus loan discount points of 3% – $4,736.22. Vol. I, Doc. 48 at G. On top of these fees, Irwin paid Homebuyers a YSP of 2.875% – $4,538.87. *Id.* Irwin's rate sheet shows that Ms. Hiers would have obtained the

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[13] Irwin incorrectly states that Premiere received only a loan origination fee and YSP in connection with the Culpeppers' loan. Pet. at 7. In fact, Premiere received almost $400 more in compensation for its origination services. Vol. I, Doc. 48 at F. Moreover, Irwin itself received over $300 for origination services it performed on the Culpeppers' loan. *Id.*

same loan at about a 5½% interest rate with no YSP to the broker. *Id.* at J.

Irwin falsely states that the Culpeppers and Ms. Hiers financed their closing costs through YSPs (Pet. at 8). That argument ignores the undisputed fact that neither of the Plaintiffs owed any additional compensation to the brokers. The Eleventh Circuit already has expressly determined that "[n]o evidence suggests that this $760.50 payment was not intended by both Premiere and the Culpeppers to compensate Premiere fully for the work it did for the Culpeppers." Pet. App. at 44a. Irwin provides no support for its contention that Homebuyers was not fully compensated by the $6,280.22 origination fee and points it received for originating Ms. Hiers' $159,750 FHA loan.

The Plaintiffs and Class Members all obtained FHA mortgage loans that were referred to Irwin by a mortgage broker in exchange for a YSP.[14]

REASONS FOR DENYING THE PETITION

Irwin has not satisfied any of this Court's requirements for granting a petition to vacate a circuit court's opinion and remand the case for reconsideration (GVR).

[14] Plaintiffs' class is defined to include only those borrowers who originated their loans through the use of a broker.

First, the issues presented by Irwin have been fully considered by the Eleventh Circuit on three prior occasions in this litigation. There is no hint, much less a "reasonable probability," that the Eleventh Circuit–if given a *fourth* opportunity to hear the Petitioner's same arguments–would reverse itself. *See Lawrence v. Chater*, 516 U.S. 163, 167 (1996) (requiring "reasonable probability that the decision below rests upon a premise that the lower court would reject if given the opportunity for further consideration"). The Eleventh Circuit already has found Irwin's interpretation of § 8 of RESPA to be irrational and in conflict with the plain language of the statute. That HUD has now espoused the same rejected argument in an improperly issued policy statement makes it no more rational or consistent with the clear language of the statute.

Moreover, under the procedural posture of this case, respect for the lower courts' continued jurisdiction and authority on remand mandates denial of the GVR Petition. Because the Eleventh Circuit's ruling was interlocutory, no final judgment has been entered and the case has been remanded to the district court for further proceedings. Not only does Irwin have the opportunity to present its arguments to the district court on remand, it already has done so. The same issues raised here by Irwin have been fully briefed for the district court on remand, and the parties are awaiting the district court's decision. Respect for lower courts counsels against issuance of a GVR that would deprive the district court of the opportunity to first address Irwin's arguments. The fact that these issues are pending below eliminates any concern that Irwin will face an adverse judgment, the basis for

which has not been fully considered, absent the grant of GVR.

Furthermore, a resolution of the issue presented by Irwin would not be dispositive. The district court also has before it other issues, such as the applicability of the "law of the case" doctrine, similar principles of *stare decisis*, and the viability of the current and alternative class definitions under the 2001 policy statement, which have not previously been addressed in the lower courts, but which may obviate the issues raised here by Irwin. This Court should deny Irwin's Petition to allow the lower courts to first address these related issues so that in the event the case returns to this posture, this Court will have a full record on all issues potentially bearing on the applicability of the 2001 policy statement to the facts of this case.

Although Petitioner alternatively seeks plenary review, it has admitted that the opinion below does not conflict with a decision of any other circuit court of appeals. Irwin has suggested no other basis for a grant of plenary review, and accordingly has failed to provide this Court any appropriate basis for plenary review.[15]

I. PETITIONER HAS PRESENTED NO COMPELLING NEED FOR THE GRANT OF "GVR."

This Court has cautioned that its GVR power "should be exercised sparingly." *Lawrence v. Chater*, 516 U.S. 163, 173 (1996). GVR is appropriate only when the court below

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[15] Even so, plenary review is not appropriate because the opinion below was correctly decided.

did not fully consider potentially determinative factors that undermine the basis for its holding and when there is also a "reasonable probability" that the circuit court would substantially modify its holding if given the opportunity to reconsider. *Id.* at 167. Even in such cases, a grant of GVR is not automatic, but depends on a balance of the equities. *Id.* at 168. None of these factors supports a grant of GVR in this case.

A. The Eleventh Circuit Will Have an Opportunity to Hear Petitioner's Arguments After the Record Is Developed on Remand to the District Court.

Unlike other cases in which this Court has issued an order of GVR, no final judgment has been entered in this case. Irwin is in no danger of having a judgment against it become final without an opportunity for the courts to fully consider potentially determinative new factors. To the contrary, this case is on remand to the district court, and Irwin has argued the very same issues there that it asserted in its Petition, *i.e.*, that HUD's 2001 policy statement is entitled to deference and negates the Eleventh Circuit's opinions below. The parties have fully briefed these and related issues discussed *infra*. As of the date of this Response, the parties are awaiting the district court's ruling.

Whatever determination the district court makes will at the appropriate time become appealable to the Eleventh Circuit, so there is no credence to Irwin's assertion that absent GVR, the Eleventh Circuit will have been deprived of the opportunity to consider the impact of

HUD's 2001 policy statement on its earlier opinions.[16] Irwin is fully protected against entry of an ill-considered judgment. The equities strongly favor denial of the Petition.

B. Additional Issues Are Awaiting the District Court's Decision on Remand That May Prove Dispositive.

Even if Irwin is correct that HUD's 2001 policy statement would otherwise be entitled to deference, related issues presented to the trial court may prove dispositive. For example, the district court could reject Irwin's arguments based on the "law of the case" doctrine or *stare decisis* in light of the fact that the Eleventh Circuit first rejected Irwin's (and now HUD's) statutory interpretation in 1998, a year before HUD's 1999 policy statement and three years before the 2001 policy statement.[17] The Eleventh Circuit expressly reserved a ruling on the applicability of these doctrines (Pet. App. at 9a) so these issues are being addressed for the first time by the district court.

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[16] Likewise, the Eleventh Circuit has requested briefs on the significance of, and amount of deference due, HUD's 2001 policy statement in three other cases challenging YSPs under § 8 of RESPA. *Heimmerman v. First Union Mortgage Corp.*, 188 F.R.D. 403 (N.D. Ala. 1999), *petition to appeal granted*, No. 99-14066 (11th Cir. Oct. 19, 1996); *McBride v. ReliaStar Mortgage Corp.*, No. 1:98-CV-215-TWT (N.D. Ga. Apr. 29, 1999), *petition to appeal granted*, No. 99-12110 (11th Cir. Oct. 19, 1999); *Hirsch v. BankAmerica Corp.*, No. 1:98-CV-1031-ODE (N.D. Ga. Apr. 20, 1999), *petition to appeal granted*, No. 001183-TT (11th Cir. June 9, 1999).

[17] Moreover, the Plaintiffs' and almost all class members' loans were closed prior to even the 1999 policy statement.

The district court also has under consideration the issue of whether, if due deference, the 2001 policy statement may be applied retroactively to defeat this class. *See NBC v. Satellite Broadcast Networks*, 940 F.2d 1467, 1470 n.4 (11th Cir. 1991); *see also Bowen v. Georgetown Gen. Hosp.*, 488 U.S. 204, 208 (1988) ("[A] statutory grant of legislative rulemaking authority will not . . . be understood to encompass the power to promulgate retroactive rules unless that power is conveyed by Congress in express terms.").

Additionally, in the unlikely event the district court determines that the 2001 policy statement governs this case, the district court will be called upon to consider whether the current (or alternative) class definitions nevertheless pass muster under that analysis. The Eleventh Circuit expressly reserved an opinion on a "fallback" position argued by the Plaintiffs "that FHA regulations applicable to FHA loans make any compensation to the broker over 1% of the loan value per se unreasonable." Pet. App. at 121. If the district court disagrees with this argument, it then will be called upon to address alternative class definitions that include only YSPs that are so egregious as to be unreasonable as a matter of law–such as a class including only mortgage loan transactions in which Irwin paid mortgage brokers a YSP for the referral of an above par (*i.e.*, higher interest rate) loan, even though the borrower paid "discount points" to ***reduce*** the interest rate.

Any of these issues pending before the district court could moot the issues here. The parties should be permitted to further develop their positions and the record on these related issues in the courts below before requiring

the Eleventh Circuit to address Irwin's arguments a fourth time.

C. The Eleventh Circuit Has Fully Considered–and Rejected as Irrational and Inconsistent With the Statute–the "Reasonableness of Total Compensation" Test for § 8 Liability Adopted by the 2001 Policy Statement.

GVR is inappropriate because the Eleventh Circuit has fully considered and rejected the statutory interpretation espoused in HUD's 2001 policy statement. Although the 2001 policy statement was not released until after issuance of the Eleventh Circuit's opinion below, the "reasonableness of total compensation" test for § 8 liability adopted in that policy statement has been advanced by Irwin for years, and has been repeatedly rejected by the Eleventh Circuit as irrational and inconsistent with the clear language of the statute.

Section 8(a) of RESPA plainly and unambiguously prohibits the payment or receipt of referral fees in connection with the closing of a federally related residential mortgage. 12 U.S.C. § 2607(a). Irwin claims an exemption from liability for its YSPs under § 8(c)(2), which exempts payments for goods or services actually provided. 12 U.S.C. § 2607(c)(2).

Irwin's contention that YSPs are used to pay for brokers' services is based on its argument that the ***potential*** exists for mortgage brokers to reduce their charges to borrowers in anticipation of receiving a YSP from lenders such as Irwin. Despite its failure to produce any evidence that the Plaintiffs or any class members did, in fact, enjoy

any reduction in up-front costs resulting from YSP payments, Irwin argues that its YSPs paid to brokers for the referral of loans nevertheless constitute "payments . . . for services actually performed," and are thus entitled to an exemption from liability under § 8(c)(2). According to Irwin, since all brokers perform services for borrowers, a lender's YSP payment to a broker–regardless of the lender's intent in making the payment–can constitute an illegal referral fee *only* to the extent that the total compensation received by the broker exceeds "reasonable" compensation for the broker's services as determined by industry standards (hereafter, the " 'reasonableness of total compensation' test").

The clarity of the statute led the Eleventh Circuit to first reject Irwin's "reasonableness of total compensation" test in this case in 1998. The Eleventh Circuit ruled that Irwin's YSP to the Plaintiffs' broker violated § 8(a) because it was undisputed that they did not owe any additional compensation for their broker's services in excess of their 1% loan origination fee. Pet. App. at 43a-44a. The Eleventh Circuit further rejected Irwin's assertion that referral fees are prohibited by § 8(a) only if total compensation received by the mortgage broker was unreasonable, and instead found such a reasonableness test to have value only in those limited cases in which an otherwise agreed and appropriate payment to a broker (such as for a credit report) "is so excessive that the excess should be characterized as a referral fee." *Id.* at 45a.

The 1999 policy statement implicitly recognized and acquiesced in the Eleventh Circuit's earlier *Culpepper*

opinions[18] and established a two-pronged test for § 8 liability consistent with *Culpepper*:

> In determining whether a payment from a lender to a mortgage broker is permissible under Section 8 of RESPA, the first question is whether goods or facilities were actually furnished or services were actually performed for the compensation paid. . . . The second question is whether the payments are reasonably related to the value of the goods or facilities that were actually furnished or services that were actually performed.

Id. at 93a. In prior arguments to the courts below, Irwin construed the "first prong"of the test by omitting the "for the compensation paid" language. In Irwin's analysis, the first prong is satisfied in every case because the broker performs some services for every brokered loan. *Id.* at 8a-9a.

Plaintiffs argued that in order to pass muster under the first prong of the 1999 HUD policy statement test and to be consistent with *Culpepper I* and the clear terms of § 8, the YSP must be paid in exchange for the broker's services. The district court agreed and certified the class since no other significant issues were raised by Irwin.

The Eleventh Circuit accepted Irwin's interlocutory appeal of the order pursuant to Fed. R. Civ. P. 23(f). Irwin reiterated its "reasonableness of total compensation" test,

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[18] *See* Pet. App. at 91a (stating that HUD was providing its views on "the legality of fees to mortgage brokers from lenders **under existing law**") (emphasis added).

which the circuit court again rejected as inconsistent with the statute. *Id.* at 9a-12a.

Most importantly, the Eleventh Circuit found no ambiguity in the language of the statute, nor did it merely resolve an ambiguity in the language of the 1999 policy statement. Irwin's contention that the court of appeals "determined that RESPA was ambiguous" (Pet. 21) is unsupported by any citation and simply is not true, thus undercutting its entire argument that HUD, as the agency charged with resolving statutory ambiguities, should be given deference. The Eleventh Circuit's *Culpepper* decisions amply demonstrate that the Eleventh Circuit premised its conclusions on its reading of the plain language of the statute and concluded that Irwin's (and now HUD's) interpretation of the 1999 policy statement conflicted with that explicit language. The following quotes from *Culpepper III* are illustrative:

- "[W]e should avoid reading § 8(c) to bless conduct that § 8(a) plainly outlaws." *Id.*
- "Under § 8(a), a payment whose reason is to compensate for referrals is illegal, period." *Id.* at 11a.
- "If Irwin has read the HUD Statement correctly, however, HUD has now decided that § 8(c) deems *some* such referral fees legal – that is, referral fees that are paid by lenders and that would be reasonable service fees, if that's what they were. The plaintiffs' reading of the HUD Statement, by contrast, keeps § 8(c) as a gloss on § 8(a): Paying referral fees may be prohibited (as § 8(a) provides), but paying service fees is not (as § 8(c) provides), unless of course the lender pays so much that we can legitimately suspect a disguised referral fee. We prefer this reading of the HUD

Statement, which preserves the harmony of § 8(a) and 8(c)." *Id.*

- "The statute itself thus implies very strongly that only payments whose reason is compensation for services fall within § 8(c)'s safe harbor, and we hesitate to read the HUD Statement to stray from the statute by imposing no such limit on legality." *Id.* at 10a.

- "Irwin's reading of the Statement is not only inconsistent with the Statement itself; it also would make the Statement clash with § 8(c)'s language." *Id.*

- "[A]ccepting Irwin's view would have the HUD Statement create an inconsistency between § 8(a)'s liability test and § 8(c)'s exclusion from liability." *Id.*

- "The structure and language of the HUD Statement and of RESPA § 8 thus support the plaintiffs' proposed rule of liability far better than Irwin's." *Id.* at 11a.

The 2001 policy statement does nothing more than rehash the same "reasonableness of total compensation" test that the Eleventh Circuit already has addressed. Given the history of this litigation, it is difficult to conclude that the courts below have not had the opportunity to fully consider the arguments reduplicated here by Irwin. Both the district court and the Eleventh Circuit have extensively considered the "reasonableness of total compensation" test now contained in HUD's 2001 policy statement, and have repeatedly rejected this industry-crafted interpretation as irrational and inconsistent with

the clear statutory language.[19] GVR would serve no purpose in this case.

D. GVR Is Inappropriate Because HUD's 2001 Policy Statement is Not Entitled To Consideration, Much Less Deference.

1. Policy statements do not warrant *Chevron*-style deference.

Under *Christensen v. Harris County*, 529 U.S. 576 (2000), HUD's informal policy statement is not entitled to deference. *Id.* at 587 ("Interpretations such as those in opinion letters – like interpretations contained in policy statements, agency manuals, and enforcement guidelines, all of which lack the force of law – do not warrant *Chevron*-style deference."); *see also United States v. Mead*, 533 U.S. 218, 121 S. Ct. 2164, 2175 (2001) (Policy statements "are beyond the *Chevron* pale.").[20]

This Court accordingly has directed lower courts to draw a critical distinction between notice-and-comment rulemaking and policy statements. *See Catskill Mountains*

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[19] Indeed, although Irwin asserts that the 2001 policy statement "clarifies" the interpretation the prior HUD administration supposedly intended to articulate in its 1999 policy statement, the Eleventh Circuit has already addressed *this* contention as well, and concluded that *even if* HUD had intended in its 1999 policy statement to adopt Irwin's interpretation, such an interpretation would be irrational. *See* Pet. App. 11a.

[20] These decisions had not been issued at the time the parties briefed and argued *Culpepper III*. Any mention by the Eleventh Circuit of the deference owed the 1999 policy statement should be read in that light.

Chapter of Trout Unlimited, Inc., et al. v. City of New York, No. 00-9447, 2001 WL 1267391 at *7 (2d Cir. Oct. 23, 2001) (rejecting EPA's position taken in several policy statements regarding the Clean Water Act), Res. App. 77a.

Thus, even if remanded, the Eleventh Circuit may give respect to the 2001 policy statement only to the extent that it has "power to persuade"; that is, it should be accorded no more weight than a brief of one of the parties. *Christensen*, 529 U.S. at 587 (such interpretations "are 'entitled to respect' under our decision in *Skidmore* . . . , but only to the extent that those interpretations have the 'power to persuade.' "); *Mead*, 121 S. Ct. at 2171; *see also Skidmore v. Swift & Co.*, 323 U.S. 134 (1944).

The Eleventh Circuit already has determined that Irwin's interpretation is not persuasive. The 2001 policy statement accordingly is not entitled to deference.

2. The 2001 policy statement is not entitled to consideration because it is ultra vires.

RESPA contains two statutory grants of rulemaking authority. Section 19(a), 12 U.S.C. § 2617(a), upon which Irwin's arguments rely, is a general grant of authority that authorizes HUD to "proscribe such rules and regulations, to make such interpretations, and to grant such exemptions, as may be necessary to achieve the purposes of [RESPA]."[21] However, the section of RESPA at issue in

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[21] The 2001 policy statement purports to be an "interpretation of Section 8" issued pursuant to "Section 19(a)" of RESPA. Pet. App. at 109a.

this case, § 8(c), 12 U.S.C. § 2607(c), contains its own, more specific grant of authority:

> Nothing in this section shall be construed as prohibiting . . . (5) such other payments or classes of payments or other transfers as are specified in *regulations* prescribed by the Secretary, after consultation with the Attorney General, the Secretary of Veterans Affairs, the Federal Home Loan Bank Board, the Federal Deposit Insurance Corporation, the Board of Governors of the Federal Reserve System, and the Secretary of Agriculture. (emphasis added)

Since § 8(c)(5) pertains specifically to § 8 liability, it trumps the more general § 19(a) provision relied upon by Irwin. *See Balfour Beatty Bahamas, Ltd. v. Bush*, 170 F.3d 1048, 1050 (11th Cir. 1999) ("It is a general rule of statutory construction that a more specific statute covering a particular subject is controlling over a statutory provision covering the same subject in more general terms."). The 2001 Policy Statement is an attempt to create a class of payments that are exempt from § 8(a) liability without complying with the procedural requirements of § 8(c)(5).

HUD has never promulgated regulations regarding § 8 in compliance with § 8(c)(5) or otherwise. Its 2001 policy statement constitutes an unlawful and ultra vires attempt to sidestep the steps required of it by Congress. *See supra* n.8.

II. PLENARY REVIEW IS UNWARRANTED

Irwin admits that "the opinion below does not conflict with any other court of appeals decision," (Pet. 23) and weakly asserts only that a few district courts–without

even citing them–have reached contrary conclusions with respect to class certification (though not necessarily with respect to the same issues raised by the Petition). The prospect that a split in the circuits "might" at some time in the future develop does not present a compelling reason for granting plenary review of the decision below.

CONCLUSION

The Petition for writ of certiorari should be denied.

Respectfully submitted,

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Rules and Regulations
DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT (HUD)

Office of the Assistant Secretary for Housing – Federal Housing Commissioner
24 CFR Part 3500
[Docket No. FR-4450-N-01]

RIN 2502-AH33
Real Estate Settlement Procedures Act (RESPA) Amended Statement of Policy 1999-1 Regarding Lender Payments to Mortgage Brokers
Part IV

DATE: ~~**Monday, March 1, 1999**~~ **July ___, 2001**

ACTION: **Amended** Statement of Policy 1999-1.

I. Background

A. General Background

The Conference Report on the Departments of Veterans Affairs and Housing and Urban Development, and Independent Agencies Appropriations Act, 1999 (H.R. Conf. Rep. No. 105-769, 105th Cong., 2d Sess. 260 (1998)) (FY 1999 HUD Appropriations Act) directs HUD to clarify its position on lender payments to mortgage brokers within 90 days after the enactment of the FY 1999 HUD Appropriations Act on October 21, 1998. The Report states that

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[*10080]

"Congress never intended payments by lenders to mortgage brokers for goods or facilities actually furnished or for services actually performed to be violations of [Sections 8](a) or (b) of the Real Estate Settlement Procedures Act (12 U.S.C. 2601 *et seq.*) (RESPA)]" (Id.). The Report also states that the Conferees "are concerned about the legal uncertainty that continues absent such a policy statement" and "expect HUD to work with representatives of industry, Federal agencies, consumer groups, and other interested parties on this policy statement" (Id.).

This issue of lender payments, or indirect fees, to mortgage brokers has proven particularly troublesome for industry and consumers alike. It has been the subject of litigation in more than 150 cases nationwide (see additional discussion below). To understand the issue and HUD's position regarding the legality of these payments requires background information concerning the nature of the services provided by mortgage brokers and their compensation, as well as the applicable legal requirements under RESPA.

During the last seven years, HUD has conducted three rulemakings respecting mortgage broker fees. These rulemakings first addressed definitional issues and issues concerning disclosure of payments to mortgage brokers in transactions covered under RESPA. (See 57 FR 49600 (November 2, 1992); 60 FR 47650 (September 13, 1995).) Most recently in a regulatory negotiation (see 60 FR 54794 (October 25, 1995) and 60 FR 63008 (December 8, 1995)) and then a proposed rule (62 FR 53912 (October 16, 1997)), HUD addressed the issue of the legality of payments to brokers under RESPA. In the latter, HUD proposed that payments from lenders to mortgage brokers be

presumed legal if the mortgage broker met certain specified conditions, including disclosing its role in the transaction and its total compensation through a binding contract with the borrower. This rulemaking is pending.

In July 1998, HUD and the Board of Governors of the Federal Reserve delivered to Congress a joint report containing legislative proposals to reform RESPA and the Truth in Lending Act. If the proposals in this reform package were to be adopted, the disclosure and legality issues raised herein would be resolved for any mortgage broker following certain of the proposed requirements, and consumers would be offered significant new protections.

B. Mortgage Brokerage Industry

When RESPA was enacted in 1974, single family mortgages were largely originated and held by savings and loans, commercial banks, and mortgage bankers. During the 1980's and 1990's, the rise of secondary mortgage market financing resulted in new wholesale and retail entities to compete with the traditional funding entities to provide mortgage financing. This made possible the origination of loans by retail entities that worked with prospective borrowers, collected application information, and otherwise processed the data required to complete the mortgage transaction. These retail entities generally operated with the intent of developing the origination package, and then immediately transmitting it to a wholesale lender who funded the loan. The rise in technology permitted much more effective and faster

exchange of information and funds between originators and lenders for the retail transaction.

Entities that provide mortgage origination or retail services and that bring a borrower and a lender together to obtain a loan (usually without providing the funds for loans) are generally referred to as "mortgage brokers." These entities serve as intermediaries between the consumer and the entity funding the loan, and currently initiate an estimated half of all home mortgages made each year in the United States. Mortgage brokers generally fit into two broad categories: those that hold themselves out as representing the borrower in shopping for a loan, and those that simply offer loans as do other retailers of loans. The first type may have an agency relationship with the borrower and, in some states, may be found to owe a [*10081] responsibility to the borrower in connection with the agency representation. The second type, while not representing the borrower, may make loans available to consumers from any number of funding sources with which the mortgage broker has a business relationship.

Mortgage brokers provide various services in processing mortgage loans, such as filling out the application, ordering required reports and documents, counseling the borrower and participating in the loan closing. They may also offer goods and facilities, such as reports, equipment, and office space to carry out their functions. The level of services mortgage brokers provide in particular transactions depends on the level of difficulty involved in qualifying applicants for particular loan programs. For example, applicants have differences in credit ratings, employment status, levels of debt, or experience that will

translate into various degrees of effort required for processing a loan. Also, the mortgage broker may be required to perform various levels of services under different servicing or processing arrangements with wholesale lenders.

Mortgage brokers vary in their methods of collecting compensation for their work in arranging, processing, and closing mortgage loans. In a given transaction, a broker may receive compensation directly from the borrower, indirectly in fees paid by the wholesaler or lender providing the mortgage loan funds, or through a combination of both.

Where a broker receives direct compensation from a borrower, the broker's fee is likely charged to the borrower at or before closing, as a percentage of the loan amount (e.g., 1% of the loan amount) and through direct fees (such as an application fee, document preparation fee, processing fee, etc.).

Brokers also may receive indirect compensation from lenders or wholesalers. Such indirect fees may be referred to as "back funded payments," "servicing release premiums," or "yield spread premiums." These indirect fees paid to mortgage brokers may be based upon the interest rate of each loan entered into by the broker with the borrower. These fees have been the subject of much contention and litigation. Another method of indirect compensation, also the subject of significant controversy and uncertainty, is "volume-based" compensation. This generally involves compensation to a mortgage broker by a lender based on the volume of loans that the mortgage broker delivers to the lender in a fixed period of time.

The compensation may come in the form of: (1) a cash payment to the broker based on the amount of loans the broker delivers to the lender in excess of a "threshold" or "floor amount"; or (2) provision of a lower "start rate" (often called a discount) for such loans; the compensation to the broker results from the difference in yield between the "start rate" and the loan rate. Volume based compensation may be received at settlement or well after a particular loan has closed.

Payments to brokers by lenders, characterized as yield spread premiums, are based on the interest rate and points of the loan entered into as compared to the par rate offered by the lender to the mortgage broker for that particular loan (e.g., a loan of 8% and no points where the par rate is 7.50% will command a greater premium for the broker than a loan with a par rate of 7.75% and no points).[1] In determining the price of a loan, mortgage brokers rely on rate quotes issued by lenders, sometimes several times a day. When a lender agrees to purchase a loan from a broker, the broker receives the then applicable pricing for the loan based on the difference between the rate reflected in the rate quote and the rate of the loan entered into by the borrower. In some cases, the broker can increase its revenues by arranging a loan with the consumer at a particular rate and then, based on market changes or other factors which decrease the par rate, increase his or her fees. Some consumers allege that the compensation system for brokers results in higher loan

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[1] The term "par rate" refers to the rate offered to the broker (through the lender's price sheets) at which the lender will fund 100% of the loan with no premiums or discounts to the broker.

rates for borrowers and/or that this compensation system is illegal under RESPA.

Lender payments to mortgage brokers may reduce the up-front costs to consumers. This allows consumers to obtain loans without paying direct fees themselves.[2] Where a broker is not compensated by the consumer through a direct fee, or is partially compensated through a direct fee, the interest rate of the loan is increased to compensate the broker or the fee is added to principal. In any of the compensation methods described, all costs are ultimately paid by the consumer, whether through direct fees or through the interest rate.

C. Coverage of This Policy Statement

HUD's RESPA rules, found at 24 CFR part 3500 (Regulation X), define a mortgage broker to be "a person (not an employee or exclusive agent of a lender) who brings a borrower and lender together to obtain a federally-related mortgage loan, and who renders * * * 'settlement services' " (24 CFR 3500.2(b)). In table funding, mortgage brokers may process and close loans in their own names. However, at or about the time of settlement, they transfer these loans to the lender, and the lender simultaneously advances the monies to fund the loan. In transactions

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[2] In many instances, these loans are called "no cost" or"no fee" loans. This terminology, however, may prove confusing because in such cases the costs are still paid by the borrower through a higher interest rate on the loan or by adding fees to principal. HUD's regulations implementing RESPA use the name "no cost" or "no point" loans consistent with industry practice.

where mortgage brokers function as intermediaries, the broker also provides loan origination services, but the loan funds are provided by the lender and the loan is closed in the lender's name.

In other cases, mortgage brokers may originate and close loans in their own name using their own funds or warehouse lines of credit, and then sell the loans after settlement in the secondary market. In such transactions, mortgage brokers effectively act as lenders under HUD's RESPA rules. Accordingly, the transfer of the loan obligation by, and payment to, these brokers after the initial funding is outside of RESPA's coverage under the secondary market exemption, found at 24 CFR 3500.5(b)(7), which states that payments to and from other loan sources following settlement are exempt from disclosure requirements and Section 8 restrictions. HUD's rule provides that in determining what constitutes a bona fide transfer in the secondary market, HUD considers the real source of funding and the real interest of the funding lender. (24 CFR 3500.5(b)(7).)

Because this Statement of Policy focuses on the legality of lender payments to mortgage brokers in transactions subject to RESPA, the coverage of this statement is restricted to payments to mortgage brokers in table-funded and intermediary broker transactions. Lender payments to mortgage brokers where mortgage brokers initially fund the loan and then sell the loan after settlement are outside the coverage of this statement as exempt from RESPA under the secondary market exemption.

D. RESPA and Its Legislative History

In enacting RESPA, Congress sought to protect the American home-buying public from unreasonably and unnecessarily inflated prices in the home purchasing process (S. Rep. No. 93-866 (1974) *reprinted in* 1974 [*10082] U.S.C.C.A.N. 6548). Section 2 of the Act provides:

> "significant reforms in the real estate settlement process are needed to insure that consumers throughout the Nation are provided with greater and more timely information on the nature and costs of the settlement process and are protected from unnecessarily high settlement charges caused by certain abusive practices that have developed in some areas of the country. * * * It is the purpose of this act to effect certain changes in the settlement process for residential real estate that will result –
>
> in more effective advance disclosure to home buyers and sellers of settlement costs; [and]
>
> (2) In the elimination of kickbacks or referral fees that tend to increase unnecessarily the costs of certain settlement services. * * * " 12 U.S.C. 2601.

Section 4(a) of RESPA requires the Secretary to create a uniform settlement statement which "shall conspicuously and clearly itemize all charges imposed upon the borrower and all charges imposed upon the seller in connection with the settlement" (12 U.S.C. 2603(a)).

Section 5(c) of RESPA requires the provision of a "good faith estimate of the amount or range of charges for specific settlement services the borrower is likely to incur

in connection with the settlement as prescribed by the Secretary" (12 U.S.C. 2604(c)).

Section 8(a) of RESPA, prohibits any person from giving and any person from accepting any fee, kickback, or other thing of value pursuant to any agreement or understanding that business shall be referred to any person. (See 12 U.S.C. 2607(a).) Section 8(b) also prohibits anyone from giving or accepting any portion, split, or percentage of any charge made or received for the rendering of a settlement service other than for services actually performed. (12 U.S.C. 2607(b).) Section 8(c) of RESPA provides, however, that nothing in Section 8 shall be construed as prohibiting the payment to any person of a *bona fide* salary or compensation or other payment for goods or facilities actually furnished or services actually performed. (12 U.S.C. 2607(c)(2).)

Under Section 19 of RESPA, HUD is authorized to issue rules, establish exemptions, and make such interpretations as is necessary to implement the law. (12 U.S.C. 2618(a).)

RESPA's legislative history refers to HUD-VA Reports and subsequent hearings by the Housing Subcommittee as defining "major problem areas that [had to] be dealt with if settlement costs are to be kept within reasonable bounds." (S. Rep. No. 93-866, at 6547.) One "major problem area" identified was the "[a]busive and unreasonable practices within the real estate settlement process that increase settlement costs to home buyers without providing any real benefits to them." Another major concern was "[t]he lack of understanding on the part of most home buyers about the settlement process and its costs,

which lack of understanding makes it difficult for a free market for settlement services to function at maximum efficiency."

The legislative history reveals that Congress intended RESPA to guard against these unreasonable and excessive settlement costs in two ways. Under Section 4, Congress sought to "mak[e] information on the settlement process available to home buyers in advance of settlement and requir[e] advance disclosures of settlement charges." (S. Rep. 93-866, at 6548.) The Senate Report explained that "home buyers who would otherwise shop around for settlement services, and thereby reduce their overall settlement costs, are prevented from doing so because frequently they are not apprised of the costs of these services until the settlement date or are not aware of the nature of the settlement services that will be provided."

Under Section 8, Congress sought to eliminate what it termed "abusive practices" – kickbacks, referral fees, and unearned fees. In enacting these prohibitions, Congress intended that "the costs to the American home buying public will not be unreasonably or unnecessarily inflated." (S. Rep. 93-866 at 6548.) In describing the Section 8 provisions, the Senate Report explained that RESPA "is intended to prohibit all * * * referral fee arrangements whereby any payment is made or 'thing of value' is provided for the referral of real estate settlement business." (S. Rep. 93-866, at 6551.)

The legislative history adds that "[t]o the extent the payment is in excess of the reasonable value of the goods provided or services performed, the excess may be considered a kickback or referral fee proscribed by Section

[8]." (S. Rep. 93-866, at 6551.) The Senate Report states that "reasonable payments in return for services actually performed or goods actually furnished" were not intended to be prohibited (Id).[3] It also provided that "[t]hose persons and companies that provide settlement services should therefore take measures to ensure that any payments they make or commissions they give are not out of line with the reasonable value of the services received." (Id.)

The Department has consistently held that the prohibitions under Section 8 of RESPA cover the activities of mortgage brokers, because RESPA applies to the origination, processing, and funding of a federally related mortgage loan. This became an issue when, in 1984, the 6th Circuit Court of Appeals held that in applying Section 8 as a criminal statute, the definition of settlement services did not clearly extend to the making of a mortgage loan. (*U.S.* versus *Graham Mortgage Corp.*, 740 F.2d 414 (6th Cir. 1984).) In 1992, Congress responded by amending RESPA to remove any doubt that, for purposes of RESPA, a settlement service includes the origination and making of a mortgage loan. (Section 908 of the Housing and Community Development Act of 1992 (Pub. L. 102-550, approved October 28, 1992; 104 Stat. 4413). At the same

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[3] One of the examples of abusive activities listed in the legislative history that RESPA was intended to remedy is "a title insurance company [that] may give 10% or more of the title insurance premium to an attorney who may perform no services for the title insurance company other than placing a telephone call to the company or filling out a simple application." (S. Rep. 93-866, at 6551.) Accordingly, where insufficient services are provided, RESPA is intended to prohibit payment.

time, Congress also specifically made RESPA applicable to second mortgages and refinancings. (Id.)

E. HUD's RESPA Rules

On November 2, 1992 (57 FR 49600), the Department issued a major revision of Regulation X, the rule interpreting RESPA. The rule defined the term "mortgage broker" for the first time. Under the rule, mortgage brokers are required to disclose direct and indirect payments on the Good Faith Estimate (GFE) no later than 3 days after loan application. (See 24 CFR 3500.7(a) and (c).) Such disclosure must also be provided to consumers, as a final figure, at closing on the settlement statement. (24 CFR 3500.8; 24 CFR part 3500, Appendix A (Instructions for Filling Out the HUD-1 and HUD-1A).) On the GFE and the settlement statement, lender-paid mortgage broker fees must be shown as "Paid Outside of Closing" (P.O.C.), and not computed in arriving at totals. (See 24 CFR 3500.7(a)(2) and 24 CFR part 3500, Appendix A.) The 1992 rule treats mortgage brokers as settlement service providers whose fees are disbursed at or before settlement, akin to title agents, attorneys, appraisers, etc., whose fees are subject to disclosure and otherwise subject to RESPA, including Section 8.

The 1992 rule did not explicitly take a position on whether yield spread premiums or any other named class of back-funded or indirect fees paid by lenders to brokers are *per se* legal or illegal. By illustration, codified as Illustrations of Requirements of RESPA, Fact Situations 5 and 12 in Appendix B [*10083] to 24 CFR part 3500, the 1992 rule specifically listed "servicing release premiums"

and "yield spread premiums" as fees required to be itemized on the settlement statement. Although the 1992 rule specifically acknowledged the existence of such fees and provided illustrations of how they were to be denominated on HUD disclosure forms, this requirement was intended to ensure their disclosure, but not to create a presumption of per se legality or illegality.

The anti-kickback, anti-referral fee and unearned fee provisions of RESPA are implemented by 24 CFR 3500.14. Regulation X repeats the Section 8 prohibitions against compensation for the referral of settlement service business and for the giving or accepting of any portion, split or percentage of any charge other than for services actually rendered. (24 CFR 3500.14(c).) Regulation X provides that a charge by a person for which no or nominal services are performed or for which duplicative fees are charged is an unearned fee and violates the unearned fee prohibition. (See 24 CFR 3500.14(c).) Moreover, 24 CFR 3500.14(g)(1)(iv) clarifies that Section 8 of RESPA permits "[a] payment to any person of a bona fide salary or compensation or other payment for goods or facilities actually furnished or for services actually performed."

The Department's regulations provide, under 24 CFR 3500.14(g)(2), that:

> The Department may investigate high prices to see if they are the result of a referral fee or a split of a fee. *If the payment of a thing of value bears no reasonable relationship to the market value of the goods or services provided, then the excess is not for services or goods actually performed or provided*. These facts may be used as evidence of a violation of section 8 and may serve as a basis

> for a RESPA investigation. High prices standing alone are not proof of a RESPA violation. The value of a referral (i.e., the value of any additional business obtained thereby) is not to be taken into account in determining whether the payment exceeds the reasonable value of such goods, facilities or services. * * * (emphasis supplied).

In addition, Regulation X clarifies that "[w]hen a person in a position to refer settlement service business * * * receives a payment for providing additional settlement services as part of a real estate transaction, such payment must be for services that are actual, necessary and distinct from the primary services provided by such person." (24 CFR 3500.14(g)(3).)

Since 1992, HUD has provided various interpretations and other issuances under these rules stating the Department's position that the legality of a payment to a mortgage broker is not premised on the name of the particular fee. Rather, HUD has consistently advised that the issue under RESPA is whether the compensation to a mortgage broker in covered transactions is reasonably related to the value of the goods or facilities actually furnished or services actually performed. If the compensation, or a portion thereof, is not reasonably related to the goods or facilities actually furnished or the services actually performed, there is a compensated referral or an unearned fee in violation of Section 8(a) or 8(b) of RESPA, whether the compensation is a direct or indirect payment or a combination thereof.

F. Recent HUD Rulemaking Efforts

The Department received comments on the 1992 rule's requirement that mortgage brokers disclose indirect payments from lenders on the GFE and the settlement statement. In response, the Department reviewed whether the disclosure of indirect or back-funded fees is necessary or in the borrower's interest and whether additional rulemaking was needed to clarify the legality of fees to mortgage brokers. Brokers had alleged that these disclosures were confusing to consumers and disadvantaged brokers as compared to other originators who were within the secondary market exemption and were not required to disclose their compensation for the subsequent sale of the loan. Consumer representatives said that consumers needed to understand the existence of indirect fees and whether brokers represented consumers in shopping for loans. On September 13, 1995, the Department issued a proposed rule (60 FR 47650) and in December 1995 through May 1996, embarked on a negotiated rulemaking on these subjects.

Although the negotiated rulemaking did not result in consensus, on October 16, 1997, HUD published a proposed rule (62 FR 53912) that was shaped by views from both industry and consumer representatives provided during the negotiated rulemaking (as well as by comments received from the September 13, 1995, proposed rule (60 FR 47650)). The 1997 proposed rule proposed a qualified "safe harbor" for payments to mortgage brokers under Section 8. Under the proposal, if a broker enters into a contract with consumers explaining the broker's functions (whether or not it represented the consumer) and the total compensation the broker would receive in

the transaction, before the consumer applied for a loan, HUD would presume the broker fees, both direct and indirect, to be legal. The 1997 proposal also provided, however, that this qualified safe harbor would only be available to those payments that did not exceed a test, to be established in the rulemaking, to preclude unreasonable fees. This proposal was intended, among other things, to establish that yield spread premiums paid to brokers meeting the rule's requirements were presumed legal when brokers provided consumers with prescribed information concerning the functions and compensation of mortgage brokers. The Department has received over 9,000 comments in response to this proposed rule.

G. Litigation

During the last several years, more than 150 lawsuits have been brought seeking class action certification based in whole or in part on the theory that the making of indirect payments from lenders to mortgage brokers violates Section 8 of RESPA. In various cases, plaintiffs have argued that yield spread premiums or other denominated indirect payments to brokers, regardless of their amount, constitute prohibited referral fees under Section 8(a). These plaintiffs generally argue that yield spread premiums are payments based upon the broker's ability to deliver a loan that is above the par rate. Some lawsuits have alleged that such yield spread premiums or other indirect payments are a split of fees between the lender and the broker, or are simply unearned fees and, therefore, also violate Section 8(b) of RESPA. Other challenges rely, in part, on the alleged unreasonableness of brokers'

fees. These complaints assert that under the RESPA regulations, payments must bear a reasonable relationship to the market value of the good or the service provided and that payments in excess of such amounts must be regarded as forbidden referral fees.

Many of the lawsuits involve allegations that consumers were not informed by mortgage brokers concerning the mortgage brokers' role and compensation. A common element in many allegations is that borrowers were not informed about the existence or the amount of the yield spread premiums paid to the mortgage broker, and the relationship of the yield spread premium to the direct fees that the borrower paid. The facts in these cases suggest generally that even where there were proper disclosures on the GFE and the settlement statement, borrowers allege that they were unaware of, or did not understand, that a yield spread premium was tied to the interest rate they agreed to pay, and that they could have reduced this charge or their direct [*10084] payment to the broker either by further negotiation or by engaging in additional shopping among mortgage loan providers.

Courts have been split in their decisions on these cases. Some of the decisions have concluded that yield spread premiums may be prohibited referral fees or duplicative fees in contravention of Section 8 of RESPA under the specific facts of the case. Some have held that the permissibility of yield spread premiums must be based on an analysis of whether the premiums constitute a reasonable payment, either alone or in combination with any direct fee paid by the borrower, for either the goods, services or facilities actually furnished. Because some courts have found that this necessitates an individual analysis of the

facts of each transaction, some courts have denied plaintiffs' requests for class action certification. Some courts have certified a class without reaching a conclusion on the RESPA issues. Others have held that yield spread premiums constitute valid consideration to the mortgage broker in exchange for the origination of the loan and the sale of the loan to the lender. These courts have found that the payment of yield spread premiums is one method among many of compensating the broker for the origination services rendered.

H. Reform

In July 1998, the Department and the Federal Reserve Board delivered a report to Congress recommending significant improvements to streamline and simplify current RESPA and Truth In Lending Act requirements. The Report proposed that along with a tighter and more enforceable scheme for providing consumers with estimated costs for settlements, an exemption from Section 8's prohibitions should be established for those entities that offer a package of settlement services and a mortgage loan at a guaranteed price, rate and points for the package early in the consumer's process of shopping for a loan. Such an approach, which also includes other additional consumer protection recommendations, would largely resolve these issues for any mortgage broker who chooses to abide by the requirements of this exemption. The Report's consumer protection recommendations included, among other items, that Congress consider establishment of an unfair and deceptive acts and practices remedy.

Under the "packaging" proposal set forth in the Report, settlement costs would be controlled more effectively by market forces. Consumers would be better able to comparison-shop, thereby encouraging creditors and others to operate efficiently and pass along discounts and lower prices. In addition, the Report's recommendations would greatly simplify compliance for the industry and clarify legal uncertainties that create liability risks.

I. This Policy Statement

This policy statement provides HUD's views of the legality of fees to mortgage brokers from lenders under existing law. In accordance with the Conference Report, in developing this policy statement, HUD met with representatives of government agencies, as well as a broad range of consumer and industry groups, including the Office of Thrift Supervision, the Comptroller of the Currency, the Federal Deposit Insurance Corporation, the Federal Reserve Board, the National Association of Mortgage Brokers, the Mortgage Bankers Association of America, the American Bankers Association, the Consumer Mortgage Coalition, America's Community Bankers, the Consumer Bankers Association, the Independent Bankers Association of America, AARP, the National Consumer Law Center, Consumers Union, and the National Association of Consumer Advocates.

II. RESPA Policy Statement 1999-1

A. Introduction

The Department hereby states its position on the legality of payments by lenders to mortgage brokers under the Real Estate Settlement Procedures Act (12 U.S.C. 2601 *et seq.*) (RESPA) and its implementing regulations at 24 CFR part 3500 (Regulation X). This Statement of Policy is issued pursuant to Section 19(a) of RESPA (12 U.S.C. 2617(a)) and 24 CFR 3500.4(a)(1)(ii). HUD is cognizant of the Conferees' statement in the Conference Report on the FY 1999 HUD Appropriations Act that "Congress never intended payments by lenders to mortgage brokers for goods or facilities actually furnished or for services actually performed to be violations of [Sections 8](a) or (b) (12 U.S.C. Sec. 2607) in its enactment of RESPA." (H. Rep. 105-769, at 260.) The Department is also cognizant of the congressional intent in enacting RESPA of protecting consumers from unnecessarily high settlement charges caused by abusive practices. (12 U.S.C. 2601.)

In transactions where lenders make payments to mortgage brokers, HUD does not consider such payments (i.e., yield spread premiums or any other class of named payments), to be illegal *per se*. HUD does not view the name of the payment as the appropriate issue under RESPA. HUD's position that lender payments to mortgage brokers are not illegal *per se* does not imply, however, that yield spread premiums are legal in individual cases or classes of transactions. The fees in cases or classes of transactions are illegal if they violate the prohibitions of Section 8 of RESPA.

~~In determining whether a payment from a lender~~ **Under Section 8 of RESPA, 12 U.S.C. § 2607(c), the question is whether a lender payment** to a mortgage broker is **compensation for goods or facilities actually furnished, or services actually provided. In determining whether a payment from a lender to a mortgage broker is for goods, services or facilities and therefore** permissible under Section 8 of RESPA, ~~the~~ **HUD applies a two-part test. The** first question is whether goods or facilities were actually furnished or services were actually performed ~~for the compensation paid~~. The fact that goods or facilities have been actually furnished or that services have been actually performed by the mortgage broker does not by itself make the payment legal. The second question is whether the payments are reasonably related to the value of the goods or facilities that were actually furnished or services that were actually performed.

In applying this test, HUD believes that total compensation should be scrutinized to assure that it is reasonably related to goods, facilities, or services furnished or performed to determine whether it is legal under RESPA. Total compensation to a broker includes direct origination and other fees paid by the borrower, indirect fees, including those that are derived from the interest rate paid by the borrower, or a combination of some or all. The Department considers that higher interest rates alone cannot justify higher total fees to mortgage brokers. All fees will be scrutinized as part of total compensation to determine that total compensation is reasonably related to the goods or facilities actually furnished or services actually performed. HUD believes that total compensation should be carefully considered in relation to price

structures and practices in similar transactions and in similar markets.

B. Scope

In light of 24 CFR Sec. 3500.5(b)(7), which exempts from RESPA coverage *bona fide* transfers of loan obligations in the secondary market, this policy statement encompasses only transactions where mortgage brokers are not the real source of funds (i.e., table-funded transactions or transactions involving "intermediary" brokers). In table-funded transactions, the mortgage broker originates, processes and closes the loan in the broker's own name and, at or about the time of settlement, there is a simultaneous advance of the loan funds by the lender and an assignment of the loan to that lender. (See 24 CFR 3500.2 (Definition of "table funding").) Likewise, in transactions where [*10085] mortgage brokers are intermediaries, the broker provides loan origination services and the loan funds are provided by the lender; the loan, however, is closed in the lender's name.

C. ~~Payments~~ Broker Must ~~Be for~~ Provide Compensable Goods, Facilities or Services

In the determination of whether payments from lenders to mortgage brokers are permissible under Section 8 of RESPA, the threshold question is whether there were goods or facilities actually furnished or services actually performed ~~for the total compensation paid to the mortgage broker~~. In making the determination of whether compensable services are performed, HUD's letter to the

Independent Bankers Association of America, dated February 14, 1995 (IBAA letter) may be useful. In that letter, HUD identified the following services normally performed in the origination of a loan:

(a) Taking information from the borrower and filling out the application;[4]

(b) Analyzing the prospective borrower's income and debt and pre-qualifying the prospective borrower to determine the maximum mortgage that the prospective borrower can afford;

(c) Educating the prospective borrower in the home buying and financing process, advising the borrower about the different types of loan products available, and demonstrating how closing costs and monthly payments could vary under each product;

(d) Collecting financial information (tax returns, bank statements) and other related documents that are part of the application process;

(e) Initiating/ordering VOEs (verifications of employment) and VODs (verifications of deposit);

(f) Initiating/ordering requests for mortgage and other loan verifications;

(g) Initiating/ordering appraisals;

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[4] In a subsequent informal interpretation, dated June 20, 1995, HUD stated that the filling out of a mortgage loan application could be substituted by a comparable activity, such as the filling out of a borrower's worksheet.

(h) Initiating/ordering inspections or engineering reports;

(i) Providing disclosures (truth in lending, good faith estimate, others) to the borrower;

(j) Assisting the borrower in understanding and clearing credit problems;

(k) Maintaining regular contact with the borrower, realtors, lender, between application and closing to appraise them of the status of the application and gather any additional information as needed;

(l) Ordering legal documents;

(m) Determining whether the property was located in a flood zone or ordering such service; and

(n) Participating in the loan closing.

While this list does not exhaust all possible settlement services, and while the advent of computer technology has, in some cases, changed how a broker's settlement services are performed, HUD believes that the letter still represents a generally accurate description of the mortgage origination process. For other services to be acknowledged as compensable under RESPA, they should be identifiable and meaningful services akin to those identified in the IBAA letter including, for example, the operation of a computer loan origination system (CLO) or an automated underwriting system (AUS).

The IBAA letter provided guidance on whether HUD would take an enforcement action under RESPA. In the context of the letter's particular facts and subject to the

reasonableness test which is discussed below, HUD articulated that it generally would be satisfied that sufficient origination work was performed to justify compensation if it found that:

- The lender's agent or contractor took the application information (under item (a)); and

- The lender's agent or contractor performed at least five additional items on the list above.

In the letter and in the context of its facts, HUD also pointed out that it is concerned that a fee for steering a customer to a particular lender could be disguised as compensation for "counseling-type" activities. Therefore, the letter states that if an agent or contractor is relying on taking the application and performing only "counseling type" services – (b), (c), (d), (j), and (k) on the list above – to justify its fee, HUD would also look to see that meaningful counseling – not steering – is provided. In analyzing transactions addressed in the IBAA letter, HUD said it would be satisfied that no steering occurred if it found that:

- Counseling gave the borrower the opportunity to consider products from at least three different lenders;

- The entity performing the counseling would receive the same compensation regardless of which lender's products were ultimately selected; *and*

- Any payment made for the "counseling-type" services is reasonably related to the services performed and not based on the amount of loan business referred to a particular lender.

In examining services provided by mortgage brokers and payments to mortgage brokers, HUD will look at the types of origination services listed in the IBAA letter to help determine whether compensable services are performed.[5] However, the IBAA letter responded to a program where a relatively small fee was to be provided for limited services by lenders that were brokering loans.[6]

Accordingly, the formulation in the IBAA letter of the number of origination services which may be required to be performed for compensation is not dispositive in analyzing more costly mortgage broker transactions where more comprehensive services are provided. The determinative test under RESPA is the relationship of the services, goods or facilities furnished to the total compensation received by the broker (discussed below). In addition to services, mortgage brokers may furnish goods or facilities to the lender. For example, appraisals, credit reports, and other documents required for a complete loan file may be regarded as goods, and a reasonable portion of the broker's retail or "store-front" operation may generally be regarded as a facility for which a lender may compensate a broker. However, while a broker may be compensated for goods or facilities actually furnished

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[5] In the June 20, 1995 letter, the Department clarified that the counseling test in the IBAA letter would not apply if an entity performed only non-counseling services (a, e, f, g, h, i, l, m, n) or a mix of counseling and non-counseling services (but did not rely only on the five counseling services (b, c, d, j, and k)).

[6] In the particular program reviewed by HUD in the IBAA letter, the average total compensation for performing six of the origination services listed above was below $200.

or services actually performed, the loan itself, which is arranged by the mortgage broker, cannot be regarded as a "good" that the broker may sell to the lender and that the lender may pay for based upon the loan's yield's relation to market value, reasonable or otherwise. In other words, in the context of a non-secondary market mortgage broker transaction, under HUD's rules, it is not proper to argue that a loan is a "good," in the sense of an instrument bearing a particular yield, thus justifying any yield spread premium to the mortgage broker, however great, on the grounds that such yield spread premium is the "market value" of the good.

D. Compensation Must Be Reasonably Related to Value of Goods, Facilities or Services

The fact that goods or facilities have been actually furnished or that services have been actually performed by the mortgage broker, as described in the IBAA letter, does not by itself make a payment by a lender to a mortgage [*10086] broker legal. The next inquiry is whether the payment is reasonably related to the value of the goods or facilities that were actually furnished or services that were actually performed. Although RESPA is not a rate-making statute, HUD is authorized to ensure that payments from lenders to mortgage brokers are reasonably related to the value of the goods or facilities actually furnished or services actually performed, and are not compensation for the referrals of business, splits of fees or unearned fees.

In analyzing whether a particular payment or fee bears a reasonable relationship to the value of the goods

or facilities actually furnished or services actually performed, HUD believes that payments must be commensurate with that amount normally charged for similar services, goods or facilities. This analysis requires careful consideration of fees paid in relation to price structures and practices in similar transactions and in similar markets.[7] If the payment or a portion thereof bears no reasonable relationship to the market value of the goods, facilities or services provided, the excess over the market rate may be used as evidence of a compensated referral or an unearned fee in violation of Section 8(a) or (b) of RESPA. (See 24 CFR 3500.14(g)(2).) Moreover, HUD also believes that the market price used to determine whether a particular payment meets the reasonableness test may not include a referral fee or unearned fee, because such fees are prohibited by RESPA. Congress was clear that for payments to be legal under Section 8, they must bear a reasonable relationship to the value received by the person or company making the payment. (S. Rep. 93-866, at 6551.)

The Department recognizes that some of the goods or facilities actually furnished or services actually performed by the broker in originating a loan are "for" the lender and other goods or facilities actually furnished or services actually performed are "for" the borrower. HUD does not believe that it is necessary or even feasible to identify or allocate which facilities, goods or services are

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[7] HUD recognizes that settlement costs may vary in different markets. The cost of a specific service in Omaha, Nebraska, for example, may bear little resemblance to the cost of a similar service in Los Angeles, California.

performed or provided for the lender, for the consumer, or as a function of State or Federal law. All services, goods and facilities inure to the benefit of both the borrower and the lender in the sense that they make the loan transaction possible (e.g., an appraisal is necessary to assure that the lender has adequate security, as well as to advise the borrower of the value of the property and to complete the borrower's loan).

The consumer is ultimately purchasing the total loan and is ultimately paying for all the services needed to create the loan. All compensation to the broker either is paid by the borrower in the form of fees or points, directly or by addition to principal, or is derived from the interest rate of the loan paid by the borrower. Accordingly, in analyzing whether lender payments to mortgage brokers comport with the requirements of Section 8 of RESPA, HUD believes that the totality of the compensation to the mortgage broker for the loan must be examined. For example, if the lender pays the mortgage broker $600 and the borrower pays the mortgage broker $500, the total compensation of $1,100 would be examined to determine whether it is reasonably related to the goods or facilities actually furnished or services actually performed by the broker.

Therefore, in applying this test, HUD believes that total compensation should be scrutinized to assure that it is reasonably related to goods, facilities, or services furnished or performed to determine whether total compensation is legal under RESPA. Total compensation to a broker includes direct origination and other fees paid by the borrower, indirect fees, including those that are derived from the interest rate paid by the borrower, or a

combination of some or all. All payments, including payments based upon a percentage of the loan amount, are subject to the reasonableness test defined above. In applying this test, the Department considers that higher interest rates alone cannot justify higher total fees to mortgage brokers. All fees will be scrutinized as part of total compensation to determine that total compensation is reasonably related to the goods or facilities actually furnished or services actually performed.

In so-called "no-cost" loans, borrowers accept a higher interest rate in order to reduce direct fees, and the absence of direct payments to the mortgage broker is made up by higher indirect fees (e.g., yield spread premiums). Higher indirect fees in such arrangements are legal if, and only if, the total compensation is reasonably related to the goods or facilities actually furnished or services actually performed.

In determining whether the compensation paid to a mortgage broker is reasonably related to the goods or facilities actually furnished or services actually performed, HUD will consider all compensation, including any volume based compensation. In this analysis, there may be no payments merely for referrals of business under Section 8 of RESPA. (See 24 CFR 3500.14.)[8]

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[8] The Department generally has held that when the payment is based on the volume or value of business transacted, it is evidence of an agreement for the referral of business (unless, for example, it is shown that payments are for legitimate business reasons unrelated to the value of the referrals). (See 24 CFR 3500.14(e).)

Under HUD's rules, when a person in a position to refer settlement service business receives a payment for providing additional settlement services as part of the transaction, such payment must be for services that are actual, necessary and distinct from the primary services provided by the person. (24 CFR 3500.14(g)(3).) While mortgage brokers may receive part of their compensation from a lender, where the lender payment duplicates direct compensation paid by the borrower for goods or facilities actually furnished or services actually performed, Section 8 is violated. In light of the fact that the borrower and the lender may both contribute to some items, HUD believes that it is best to evaluate seemingly duplicative fees by analyzing total compensation under the reasonableness test described above.

E. Information Provided to Borrower

Under current RESPA rules mortgage brokers are required to disclose estimated direct and indirect fees on the Good Faith Estimate (GFE) no later than 3 days after loan application. (See 24 CFR 3500.7(a) and (b).) Such disclosure must also be provided to consumers, as a final exact figure, at closing on the settlement statement. (24 CFR 3500.8; 24 CFR part 3500, Appendix A.) On the GFE and the settlement statement, lender payments to mortgage brokers must be shown as "Paid Outside of Closing" (P.O.C.), and are not computed in arriving at totals. (24 CFR 3500.7(a)(2).) The requirement that all fees be disclosed on the GFE is intended to assure that consumers are shown the full amount of compensation to brokers and others early in the transaction.

The Department has always indicated that any fees charged in settlement transactions should be clearly disclosed so that the consumer can understand the nature and recipient of the payment. Code-like abbreviations like "YSP to DBG, POC", for instance, have been noted.[9] Also, the Department has seen [*10087] examples on the GFE and/or the settlement statement where the identity and/or purpose of the fees are not clearly disclosed.

The Department considers unclear and confusing disclosures to be contrary to the statute's and the regulation's purposes of making RESPA-covered transactions understandable to the consumer. At a minimum, all fees to the mortgage broker are to be clearly labeled and properly estimated on the GFE. On the settlement statement, the name of the recipient of the fee (in this case, the mortgage broker) is to be clearly labeled and listed, and the fee received from a lender is to be clearly labeled and listed in the interest of clarity. For example, a fee would be appropriately disclosed as "Mortgage broker fee from lender to XYZ Corporation (P.O.C.)." In the interest of clarity, other fees or payments from the borrower to the

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[9] This is an example only. HUD recognizes that current practices may leave borrowers confused. However, the use of any particular terms, including abbreviations, may not, by itself, violate RESPA. Nevertheless, going forward, HUD recommends that the disclosures on the GFE and the settlement statement be as described in the text. HUD recognizes that system changes may require time for lenders and brokers to implement.

mortgage broker should identify that they are mortgage broker fees from the borrower.[10]

There is no requirement under existing law that consumers be fully informed of the broker's services and compensation prior to the GFE. Nevertheless, HUD believes that the broker should provide the consumer with information about the broker's services and compensation, and agreement by the consumer to the arrangement should occur as early as possible in the process. Mortgage brokers and lenders can improve their ability to demonstrate the reasonableness of their fees if the broker discloses the nature of the broker's services and the various methods of compensation at the time the consumer first discusses the possibility of a loan with the broker.

The legislative history makes clear that RESPA was not intended to be a rate-setting statute and that Congress instead favored a market-based approach. (S. Rep. No. 93-866 at 6546 (1974).) In making the determination of whether a payment is *bona fide* compensation for goods or facilities actually furnished or services actually performed, HUD has, in the past, indicated that it would examine whether the price paid for the goods, facilities or services is truly a market price; that is, if in an arm's length transaction a purchaser would buy the services at or near the amount charged. If the fee the consumer pays is disclosed and agreed to, along with its relationship to

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[10] HUD recognizes that current software may not currently accommodate these additional disclosures. Both industry and consumers would be better served if these additional disclosures were included in future forms.

the interest rate and points for the loan and any lender-paid fees to the broker, a market price for the services, goods or facilities could be attained. HUD believes that for the market to work effectively, borrowers should be afforded a meaningful opportunity to select the most appropriate product and determine what price they are willing to pay for the loan based on disclosures which provide clear and understandable information.

The Department reiterates its long-standing view that disclosure alone does not make illegal fees legal under RESPA. On the other hand, while under current law, pre-application disclosure to the consumer is not required, HUD believes that fuller information provided at the earliest possible moment in the shopping process would increase consumer satisfaction and reduce the possibility of misunderstanding.

HUD commends the National Association of Mortgage Brokers and the Mortgage Bankers Association of America for strongly suggesting that their members furnish consumers with a form describing the function of mortgage brokers and stating that a mortgage broker may receive a fee in the transaction from a lender.

Although this statement of policy does not mandate disclosures beyond those currently required by RESPA and Regulation X, the most effective approach to disclosure would allow a prospective borrower to properly evaluate the nature of the services and all costs for a broker transaction, and to agree to such services and costs before applying for a loan. Under such an approach, the broker would make the borrower aware of whether the broker is or is not serving as the consumer's agent to shop for a

loan, and the total compensation to be paid to the mortgage broker, including the amounts of each of the fees making up that compensation. If indirect fees are paid, the consumer would be made aware of the amount of these fees and their relationship to direct fees and an increased interest rate. If the consumer may reduce the interest rate through increased fees or points, this option also would be explained. HUD recognizes that in many cases, the industry has not been using this approach because it has not been required. Moreover, new methods may require time to implement. HUD encourages these efforts going forward and believes that if these desirable disclosure practices were adhered to by all industry participants, the need for more prescriptive regulatory or legislative actions concerning this specific problem could be tempered or even made unnecessary.

While the Department is issuing this statement of policy to comply with a Congressional directive that HUD clarify its position on the legality of lender payments to mortgage brokers, HUD agrees with segments of the mortgage lending and settlement service industries and consumer representatives that legislation to improve RESPA is needed. HUD believes that broad legislative reform along the lines specified in the HUD/Federal Reserve Board Report remains the most effective way to resolve the difficulties and legal uncertainties under RESPA and TILA for industry and consumers alike. Statutory changes like those recommended in the Report would, if adopted, provide the most balanced approach to resolving these contentious issues by providing consumers with better and firmer information about the costs associated with home-secured credit transactions

and providing creditors and mortgage brokers with clearer rules.

III. Executive Order 12866, Regulatory Planning and Review

The Office of Management and Budget (OMB) reviewed this **Amended** Statement of Policy under Executive Order 12866, *Regulatory Planning and Review.* OMB determined that this Statement of Policy is a "significant regulatory action," as defined in section 3(f) of the Order (although not economically significant, as provided in section 3(f)(1) of the Order). Any changes made to the Statement of Policy subsequent to its submission to OMB are identified in the docket file, which is available for public inspection in the office of the Department's Rules Docket Clerk, Room 10276, 451 Seventh Street, SW, Washington, DC 20410-0500.

Dated: ~~February 22, 1999. William C. Apgar~~, July , 2001.

John C. Weicher,

Assistant Secretary for Housing-Federal Housing Commissioner.

[FR Doc. ~~99-4921 Filed 2-26-99; 8:45 am] BILLING CODE 4210-27-P~~ Filed; : am]

What we are asking for:

We are not asking for elimination of class actions or wiping out liability. The clarification is only a piece of evidence as to what HUD thinks the law is.

What we are offering:

Our suggestion: A mandatory contract between the broker and the borrower that clearly establishes the amount of the payment and the method of payment. Not just disclosure, but a binding legal contract.

Why this works for Consumers and the Senate.

First the relief we are asking for is not nearly as far reaching as consumers and the Senate may have believed. They appear to think that we wanted HUD to wipe out liability and class actions. This is not what the clarification does.

Second, the mandatory contract we are proposing directly addresses the consumer and senate issues: How much the broker is getting and what the relationship is.

The Senate and consumers do not want the retroactive relief, but they do want a better system going forward. So it's a fair compromise, especially since the relief is simply a clarification and does not have the effect of ending any suits or cutting off anybody's legal rights.

How to do it:

Issue the clarification as we have proposed in a policy statement published in the federal register. Simultaneously, issue an interim rule with the new broker fee agreement effective in 30 days. This takes care of the desire of consumers and the senate to move both relief and prospective changes simultaneously.

DRAFT **DRAFT** **DRAFT**

Mortgage Broker Fee and Disclosure Agreement

In the following: I = applicant; You = mortgage broker

Mortgage Broker Services. You are duly authorized and prepared to assist me in arranging mortgage financing for my home, and I engage you to provide such service. I understand that your services may include, but are not limited to the following:

- ξ Taking my personal financial information and helping me complete my loan application
- ξ Advising me about the different types of loan products available and demonstrating how closing costs and monthly payments could vary under each product
- ξ Collecting financial information such as tax returns and bank statements that are part of the application process
- ξ Initiating/ordering requests for mortgage and other loan verifications
- ξ Initiating/ordering appraisals, inspections or engineering reports
- ξ Providing me with required disclosures such as the truth-in-lending and good faith estimate disclosures
- ξ Assisting me in understanding credit problems
- ξ Performing such other services necessary to the completion of the loan application process

Amount of Broker Fee. I understand that, as compensation for your services, your total compensation from any and all sources will not exceed:

$ _____ or _____ points (one point equals I percent of the original principal balance of the mortgage loan obtained).

Method of Broker Fee Payment. I understand that my choice as to how I want to structure my loan transaction will affect how your compensation is paid:

- ξ ***If I want to minimize my interest rate,*** I may pay higher up-front points and fees and pay you directly.
- ξ ***If I want to minimize the cash I must bring to closing,*** I may pay some or all of your compensation indirectly through a higher interest rate in which case the lender will pay you directly in whole or in part.

Nature of the Relationship. In connection with this Broker Fee and Disclosure Agreement and any mortgage loan, you are acting as my agent, except where state law provides otherwise. Although you seek to assist me in meeting my financial needs, you do not distribute the products of all lenders or investors in the market and cannot guarantee the lowest price or best terms available in the market.

Termination. This agreement will continue until one of the following events occurs:

- ξ I fail to receive loan approval;
- ξ My loan closes;
- ξ I terminate your services;
- ξ You and I enter into a new Mortgage Broker Fee and Disclosure Agreement; or

ξ _____ days expire from the date of this agreement without any of the foregoing occurring.

Mortgage Broker Fee and Disclosure Acknowledgement

By signing below, we agree to the terms of this contract. Fees received under this agreement are legal and permissible under section 8 of the Real Estate Settlement Procedures Act and 24 CFR part 3500. The obligation to comply with the Mortgage Broker Fee and Disclosure Agreement rests solely with the mortgage broker, and no other entity shall be liable for any misrepresentation or non-performance of the brokers obligations under this agreement.

Signing this contract does not obligate me to obtain a mortgage loan through this mortgage broker, nor does it constitute mortgage loan approval.

**Applicant _____ Date _____
**Applicant _____ Date _____
_____ Date _____
Mortgage Broker Signature
Mortgage Broker License No. (where applicable) _____

[Delivery. [Rule will provide that agreement must be delivered to borrower within three (3) business days of broker taking loan application.]

United States Library of Congress

S 2223
Introduced in Senate
June 25, 1998

To provide a moratorium on certain class actions relating to the **Real Estate Settlement** Procedures Act of 1974.

IN THE SENATE OF THE UNITED STATES
June 25, 1998

Mr. GRAMS (for himself, Mr. FAIRCLOTH, Mr. BRYAN, Mr. THURMOND, Mr. BREAUX, Mr. ALLARD, Mr. AKAKA, Mr. BROWNBACK, Mr. INOUYE, Mr. DOMENICI, Mr. REID, Mr. GREGG, Mr. ASHCROFT, Mr. BENNETT, Mr. MACK, Mr. MCCAIN, and Mr. ENZI) introduced the following bill; which was read twice and referred to the Committee on the Judiciary

A BILL

To provide a moratorium on certain class actions relating to the **Real Estate Settlement** Procedures Act of 1974.

Be in enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. SHORT TITLE.

This Act may be cited as the 'Mortgage Litigation Reform Act of 1998'.

Sec. 2. MORATORIUM.

Section 16 of the **Real Estate Settlement** Procedures Act of 1974 (12 U.S.C. 2614) is amended –

(1) by inserting '(a) IN GENERAL- ' after 'SEC. 16.'; and

(2) by adding at the end the following new subsection:

'(b) **CLASS ACTION MORATORIUM-**

'(1) IN GENERAL- During the period beginning on the date of enactment of the Mortgage Litigation Reform Act of 1998 and ending on July 1, 1999, in any State or Federal civil action arising under this Act in which it is alleged that a payment of a thing of value was made by a lender to another lender or to a mortgage broker –

'(A) no party shall serve or cause to be served, or be required to respond to, any discovery concerning any class certification issue;

'(B) no Federal or State court may enter any order –

'(i) certifying any class, other than an order certifying any class directly in connection with the settlement and compromise of any action; or

'(ii) imposing any sanction on any party for failing to comply with any discovery seeking information concerning any class certification issue; and

'(C) all Federal and State courts shall stay all further proceedings in any such action in which an

order certifying any class has been entered on or after January 1, 1998, for any purpose other than indirect connection with the settlement and compromise of any such action.

'(2) NO EFFECT ON OTHER ACTIONS- Nothing in this subsection shall be construed to limit or affect any civil action arising under this Act that is not brought by or on behalf of a class.'.

1998 CONG US S 2223

United States Library of Congress

HR 1283
Introduced In House
April 10, 1997

To provide a moratorium on certain class action lawsuits relating to the **Real Estate Settlement** Procedures Act of 1974.

IN THE HOUSE OF REPRESENTATIVES
April 10, 1997

Mr. EHRLICH (for himself, Mr. NEY, Mr. FOX of Pennsylvania, Mr. LIPINSKI, Mr. BACHUS, Mr. BARR of Georgia, Mr. METCALF, Mr. BAKER, Mrs. KELLY, Mr. LATOURETTE, Mr. SNOWBARGER, Mr. KING, Mr. HEFLEY, Mr. CHABOT, Mr. JONES, Mr. INGLIS of South Carolina, and Mr. NEWMANN, Mr. RAMSTAD, and Mr. WELLER) introduced the following bill; which was read twice and referred to the Committee on Banking and Financial Services, and in addition to the Committee on the Judiciary, for a period to be subsequently determined by the Speaker, in each case for consideration of such provisions as fall within the jurisdiction of the committee concerned

A BILL

To provide a moratorium on certain class action lawsuits relating to the **Real Estate Settlement** Procedures Act of 1974.

Be in enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. SHORT TITLE.

This Act may be cited as the '**Real Estate Settlement** Procedures Act Class Action Relief of 1997'.

Sec. 2. MORATORIUM.

Section 16 of the **Real Estate Settlement** Procedures Act of 1974 (12 U.S.C. 2614) is amended –

(1) by inserting '(a) IN GENERAL- ' after 'SEC. 16.'; and

(2) by adding at the end the following new subsection:

'(b) **CLASS ACTION MORATORIUM-** During the period beginning on the date of enactment of the **Real Estate Settlement** Procedures Act Class Action Relief Act of 1997 and ending on December 31, 1998, in any State or Federal civil action or lawsuit arising under this Act in which it is alleged that a payment of a thing of value was made by a lender to another lender or to a mortgage broker –

'(1) no party shall serve or cause to be served, or be required to respond to, any discovery concerning any class certification issue;

'(2) no State or Federal court may enter any order –

'(A) certifying any class, except an order certifying any class directly in connection with the settlement and compromise of any action; or

'(B) Imposing any sanctions on any party for failing to comply with any discovery seeking information concerning any class certification issue; and

'(3) all State and Federal courts shall stay all further proceedings in any such action in which an order certifying any class has been entered on or after January 1, 1996, for any purpose other than indirect connection with the settlement and compromise of any such action.'.

1997 CONG US HR 1283

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12 U.S.C. § 2601. Congressional findings and purpose

(a) The Congress finds that significant reforms in the real estate settlement process are needed to insure that consumers throughout the Nation are provided with greater and more timely information on the nature and costs of the settlement process and are protected from unnecessarily high settlement charges caused by certain abusive practices that have developed in some areas of the country. The Congress also finds that it has been over two years since the Secretary of Housing and Urban Development and the Administrator of Veterans' Affairs submitted their joint report to the Congress on "Mortgage Settlement Costs" and that the time has come for the recommendations for Federal legislative action made in that report to be implemented.

(b) It is the purpose of this chapter to effect certain changes in the settlement process for residential real estate that will result –

(1) in more effective advance disclosure to home buyers and sellers of settlement costs;

(2) in the elimination of kickbacks or referral fees that tend to increase unnecessarily the costs of certain settlement services;

(3) in a reduction in the amounts home buyers are required to place in escrow accounts established to insure the payment of real estate taxes and insurance; and

(4) in significant reform and modernization of local record-keeping of land title information.

12 U.S.C. § 2607. Prohibition against kickbacks and unearned fees

* * *

(d) Penalties for violations; joint and several liability; treble damages; actions for injunction by Secretary and by State officials; costs and attorney fees; construction of State laws

(1) Any person or persons who violate the provisions of this section shall be fined not more than $10,000 or imprisoned for not more than one year, or both.

(2) Any person or persons who violate the prohibitions or limitations of this section shall be jointly and severally liable to the person or persons charged for the settlement service involved in the violation in an amount equal to three times the amount of any charge paid for such settlement service.

(3) No person or persons shall be liable for a violation of the provisions of subsection (c)(4)(A) of this section if such person or persons proves by a preponderance of the evidence that such violation was not intentional and resulted from a bona fide error notwithstanding maintenance of procedures that are reasonably adapted to avoid such error.

(4) The Secretary, the Attorney General of any State, or the insurance commissioner of any State may bring an action to enjoin violations of this section.

(5) In any private action brought pursuant to this subsection, the court may award to the prevailing party

the court costs of the action together with reasonable attorneys fees.

(6) No provision of State law or regulation that imposes more stringent limitations on controlled business arrangements shall be construed as being inconsistent with this section.

[LOGO]

U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
WASHINGTON, D.C. 20410-0500

December 17, 1999

OFFICE OF THE GENERAL COUNSEL

The Honorable Bruce F. Vento
U.S. House of Representatives
Washington, DC 20515-2304

Dear Representative Vento:

This is in response to your letter dated December 7, 1999, asking three questions on behalf of your constituents regarding lender payments to mortgage brokers under the Real Estate Settlement Procedures Act (RESPA). Specifically, you ask: (1) whether, in its Statement of Policy 1999-1 (64 Fed.Reg. 10084), HUD intended to change existing law and create a new less stringent legal standard; (2) what factors HUD examines in determining whether payments to mortgage brokers are legal under RESPA; and (3) whether HUD intended the Police Statement to weaken the referral fee prohibitions contained in RESPA.

Regarding the first question, as requested in the Conference Report on the Departments of Veterans Affairs and Housing and Urban Development and Independent Agencies Appropriations Act, 1999 (H.R. Conf. Rep. No. 105-769), on March 1, 1999, HUD issued Statement of Policy 1999-1 regarding the legality of mortgage lender payments to mortgage brokers under RESPA. The preamble to the Statement of Policy expressly states that it "provides HUD's views of the legality of fees to mortgage

brokers from lenders under existing law." 64 Fed.Reg. 10084. In accordance with its express language, HUD did not intend for the Policy Statement to create a new legal standard or to change existing law.

As to the second question, the Policy Statement makes clear that HUD does not consider lender payments to mortgage brokers illegal *per se*. The Policy Statement articulates a two-part test to determine the legality of yield spread or other payments to mortgage brokers from lenders. HUD's position is that for a payment from a lender to a mortgage broker to be permissible under RESPA: (1) goods or facilities must have been furnished or services must have been performed "for" – i.e., in exchange for – the compensation paid to the broker; and (2) the broker's compensation must be reasonably related to the value of the services performed, or the goods or facilities provided, by the broker. 64 Fed.Reg. 10084. Regarding the first test, the Policy Statement sets out the minimum types and extent of services that a mortgage broker must perform in order to justify compensation to the broker. The Policy Statement then provides that "[t]he fact that goods or facilities have been actually furnished or that services have been actually performed by the mortgage broker . . . does not by itself make a payment by a lender to a mortgage broker legal." 64 Fed.Reg. 10085-6. Accordingly, the mere performance of any service by a mortgage broker is not in itself sufficient to establish that the payment to the broker was made in exchange for those services. "The next inquiry is whether the payment is reasonably related to the value of the goods or facilities that were actually furnished or services that were actually performed." 64 Fed.Reg. 10086. In

applying this second test, the total compensation from the lender and the borrower should be scrutinized to assure that the payment is reasonably related to goods, facilities, or services furnished or performed. 64 Fed.Reg. 10084 and 10086. Moreover, the Policy Statement also makes clear that in analyzing whether any transaction under RESPA and its regulations involves compensation for "goods," a mortgage loan is not a "good," and that the referral of a loan is not a compensable service. 64 Fed.Reg. 10085 and 10086. HUD stated that mortgage brokers and lenders could better demonstrate the reasonableness of mortgage broker compensation if, at the time a consumer first discusses the possibility of a loan with a broker, the broker discloses the nature of its services and the various methods of its compensation. At a minimum, mortgage brokers are required to clearly label and properly estimate their fees on the Good Faith Estimates. 64 Fed.Reg. 10087.

Finally, the preamble to the Policy Statement affirms that "[t]he Department has consistently held that the prohibitions under Section 8 of RESPA cover the activities of mortgage brokers." 64 Fed.Reg. 10082. Moreover, it says that "[t]he fees in cases or classes of transactions are illegal if they violate the prohibitions of Section 8 of RESPA." 64 Fed.Reg. 10084. HUD, therefore, never intended for its Policy Statement to weaken the prohibitions contained in Section 8 of RESPA and indeed, in elucidating the tests for when fees could be legal, sought to establish a brighter line defining illegal conduct. HUD is committed to assuring that consumers receive all of the protections that Congress afforded under RESPA.

I appreciate your interest in the Department's programs. If I can be of further assistance, please contact me.

Sincerely,

/s/ Gail W. Laster
Gail W. Laster
General Counsel

[LOGO]

U.S. DEPARTMENT OF HOUSING
AND URBAN DEVELOPMENT
WASHINGTON, D.C. 20410-0500

OFFICE OF THE GENERAL COUNSEL

MAR 21, 2000

The Honorable Richard Shelby
United States Senate
Washington, D.C. 20510-0103

Dear Senator Shelby:

I regret the delay in responding to your letter dated November 19, 1999. In this response we answer three questions from your constituent, Mr. Leonard V. Zumpano, Director of the Alabama Research and Education Center at the University of Alabama, regarding lender payments to mortgage brokers under the Real Estate Settlement Procedures Act (RESPA). Specifically, Mr. Zumpano asks: (1) whether HUD intended for its recent Statement of Policy on this subject to create a new legal standard or to change existing law; (2) whether in order to be legal under RESPA, lender payments must be paid in exchange for goods, facilities or services actually provided by the broker, or whether "reasonable" payments are legal regardless of the purpose of the fees; and (3) whether HUD intends for its Policy Statement to weaken the referral fee prohibitions contained in RESPA.

Regarding the first question, as requested in the Conference Report on the Departments of Veterans Affairs and Housing and Urban Development and Independent Agencies Appropriations Act, 1999 (H.R. Conf. Rep. No.

105-769), on March 1, 1999, HUD issued Statement of Policy 1999-1 regarding the legality of mortgage lender payments to mortgage brokers under RESPA. The preamble to the Statement of Policy expressly states that it "provides HUD's views of the legality of fees to mortgage brokers from lenders under existing law." 64 Fed.Reg. 10084. In accordance with its express language, HUD did not intend for the Policy Statement to create a new legal standard or to change existing law.

As to the second question, the Policy Statement makes clear that HUD does not consider lender payments to mortgage brokers illegal *per se*. The Policy Statement articulates a two-part test to determine the legality of yield spread or other payments to mortgage brokers from lenders. HUD's position is that for a payment from a lender to a mortgage broker to be permissible under RESPA: (1) goods or facilities must have been furnished or services must have been performed "for" – i.e., in exchange for – the compensation paid to the broker; and (2) the broker's compensation must be reasonably related to the value of the services performed, or the goods or facilities provided, by the broker. 64 Fed.Reg. 10084. Regarding the first test, the Policy Statement sets out the minimum types and extent of services that a mortgage broker must perform in order to justify compensation to the broker. The Policy Statement then provides that "[t]he fact that goods or facilities have been actually furnished or that services have been actually performed by the mortgage broker . . . does not by itself make a payment by a lender to a mortgage broker legal." 64 Fed.Reg. 10085-6. Accordingly, the mere performance of any service by a mortgage broker is not in itself sufficient to

establish that the payment to the broker was made in exchange for those services. "The next inquiry is whether the payment is reasonably related to the value of the goods or facilities that were actually furnished or services that were actually performed." 64 Fed.Reg. 10086. In applying this second test, the total compensation from the lender and the borrower should be scrutinized to assure that the payment is reasonably related to goods, facilities, or services furnished or performed. 64 Fed.Reg. 10084 and 10086. Moreover, the Policy Statement also makes clear that in analyzing whether any transaction under RESPA and its regulations involves compensation for "goods," a mortgage loan is not a "good," and that the referral of a loan is not a compensable service. 64 Fed.Reg. 10085 and 10086. HUD stated that mortgage brokers and lenders could better demonstrate the reasonableness of mortgage broker compensation if, at the time a consumer first discusses the possibility of a loan with a broker, the broker discloses the nature of its services and the various methods of its compensation. At a minimum, mortgage brokers are required to clearly label and properly estimate their fees on the Good Faith Estimates. 64 Fed.Reg. 10087.

Finally, the preamble to the Police Statement affirms that "[t]he Department has consistently held that the prohibitions under Section 8 of RESPA cover the activities of mortgage brokers." 64 Fed.Reg. 10082. Moreover, it says that "[t]he fees in cases or classes of transactions are illegal if they violate the prohibitions of Section 8 of RESPA." 64 Fed.Reg. 10084. HUD, therefore, never intended for its Policy Statement to weaken the prohibitions contained in Section 8 of RESPA and indeed, in

elucidating the tests for when fees could be legal, sought to establish a brighter line defining illegal conduct. HUD is committed to assuring that consumers receive all of the protections that Congress afforded under RESPA.

I appreciate your interest in the Department's programs. If I can be of further assistance, please contact me.

Sincerely,
/s/ Gail W. Laster
Gail W. Laster
General Counsel

COLLECTIONS WORLD [LOGO]

Thursday, July 12, 2001

Lenders Ask HUD to Clarify Legality of Yield Spread Premiums

WASHINGTON

Mortgage lenders are urging the Department of Housing and Urban Development to issue a clarification of its yield-spread premium policy statement in the wake of the Culpepper decision by the U.S. Court of Appeals in Atlanta.

"We are making a case to HUD," said Howard Glaser, who is in charge of government affairs at the Mortgage Bankers Association.

The MBA contends that the appeals court misinterpreted the HUD policy statement when it cleared the way for a class action lawsuit (Culpepper v. Irwin Mortgage Corp.) to go [sic] trial.

YSP premiums are used in 50% of all mortgage transactions and the appeals court has ruled that YSPs are de facto illegal, Mr. Glasersaid [sic].

If HUD issues a clarification, it would provide some comfort for wholesale lenders who continue to compensate mortgage brokers through the payment of YSPs. "But more importantly, it would dilute the potential impact of Culpepper with other courts," said Larry Platt, a partner at the Washington law firm of Kirkpatrick & Lockhart.

Meanwhile, Irwin Mortgage, based in Indianapolis, is expected to file a request for all the circuit judges on the Atlanta appeals court to rehear the Culpepper case.

The payment of yield-spread premiums allows brokers to roll the cost of points into the interest rate of a loan, as well as their fees for originating the loan. The HUD policy statement says YSPs are not illegal per se, provided the fees are reasonable and are related to services provided.

YSPs also reduce the amount of cash borrowers have to bring to the closing table. And by rolling other closing costs into the loan amount, lenders can offer consumers "zero-cost" loans.

"Absent a reversal, MBA believes the (Culpepper) decision will increase the cost of credit to consumers and sharply curtail, if not eliminate, an important mechanism for providing borrowers with needed flexibility in structuring their mortgage transactions," the MBA said in a statement.

The MBA and others are concerned that the Culpepper decision will trigger a flood of lawsuits against lenders.

"If HUD does not issue a clarification relatively quickly, we will have to seek emergency legislative relief," said Wright Andrews, a Washington lobbyist with Butera & Andrews.

Getting Congress to act would not be easy, he admitted, but the litigation could be "devastating to a whole lot of companies." Several industry officials noted that getting legislative relief would be nearly impossible and it would take too long to be effective.

Besides the potential liability, wholesaler lenders also have to worry about market share if they lose the ability

to pay YSPs, according to mortgage industry expert Allen Hardester, who is based in Columbia, Md.

"YSPs are just an easy way for wholesalers to induce brokers to deliver loans and it can be abused," Mr. Hardester said.

The general counsel for the National Association of Mortgage Brokers believes something has to be done quickly to blunt the impact of the Culpepper decision and he believes HUD shares that sense of urgency.

"HUD has been very responsive," said NAMB general counsel Robert Lotstein of the Washington law firm of Lotstein Buckman.

"We are confident, based on the new administration and the people appointed, that they are going to be responsive to this problem" Mr. Lotstein said.

He also noted class action lawyers have started to advertise for clients so that they can file new cases against lenders. *(7/12)*

Only the Westlaw citation is currently available.

United States Court of Appeals, Second Circuit.

CATSKILL MOUNTAINS CHAPTER OF TROUT UNLIMITED, INC., Theodore Gordon Flyfishers, Inc., Catskill-Delaware Natural Water Alliance, Inc., Federated Sportsmen's Clubs of Ulster County, Inc. and Riverkeeper, Inc., Plaintiffs-Appellants,

v.

The CITY OF NEW YORK, New York City Department of Environmental Protection and Joel A. Miele, Sr., Commissioner of Department of Environmental Protection, Defendants-Appellees.

No. 00-9447.

Argued May 25, 2001.
Decided Oct. 23, 2001.

Karl S. Coplan, Pace Environmental Litigation Clinic, Inc. (Basil B. Seggos, on the brief), White Plains, NY, for Appellants.

Ellen S. Ravitch, Office of the Corporation Counsel of the City of New York (Michael D. Hess, Stephen J. McGrath, Hillary Meltzer, and William S. Plache, on the brief), New York, NY, for Appellees.

Before WALKER, Chief Judge, KATZMANN and CUDAHY,* Circuit Judges.

JOHN M. WALKER, JR., Chief Judge:

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* The Honorable Richard D. Cudahy of the United States Court of Appeals for the Seventh Circuit, sitting by designation.

Plaintiff environmental organizations Catskill Mountains Chapter of Trout Unlimited, Inc., Theodore Gordon Flyfishers, Inc., Catskill-Delaware Natural Water Alliance, Inc., Federated Sportsmen's Clubs of Ulster County, Inc., and Riverkeeper, Inc. (collectively "Catskill") appeal from an October 6, 2000 order of the United States District Court for the Northern District of New York (Frederick J. Scullin, Jr., *Chief District Judge*) granting a motion to dismiss under Fed.R.Civ.P. 12(b)(6) made by defendants City of New York, New York City Department of Environmental Protection, and Joel A. Miele, Sr., Commissioner of the Department of Environmental Protection (collectively "New York City" or "the City"). We conclude that some of Catskill's claims should not have been dismissed and those that were properly dismissed should have been dismissed without prejudice. Accordingly, we reverse in part, vacate in part, and remand for further proceedings consistent with this opinion.

BACKGROUND

Since before World War II, New York City has operated Schoharie Dam and Reservoir in the Catskill Mountains, to provide drinking water for New York City. Water is diverted south from the Schoharie Reservoir ("the Reservoir") through the Shandaken Tunnel ("the Tunnel") for several miles and released into Esopus Creek ("the Creek"), which in turn empties into Ashokan Reservoir. The transfer of water from the Reservoir to Esopus Creek and Ashokan Reservoir facilitates its delivery to New York City for use as drinking water.

Absent the tunnel, water leaving the Reservoir would flow north in Schoharie Creek, join the Mohawk River, and flow into the Hudson River. Water from Esopus Creek, on the other hand, makes its way southeast to the Hudson by way of Ashokan Reservoir. Schoharie Reservoir and Esopus Creek are hydrologically connected only insofar as both are tributaries of the Hudson. Under natural conditions, water from the Schoharie Reservoir would never reach Esopus Creek.

Plaintiffs-appellants primarily represent recreational users of Esopus Creek. On November 20, 1998, Catskill sent a letter to the City, the United States Environmental Protection Agency ("EPA"), and the New York State Department of Conservation ("NYSDEC"), indicating Catskill's intention to file suit in district court under the federal Clean Water Act ("CWA," "the Act"), 33 U.S.C. § 1251 et seq. The Act permits aggrieved parties to bring civil actions to enforce certain of the statute's requirements against alleged violators. *See* 33 U.S.C. § 1365 ("Citizen suits").

On March 31, 2000, Catskill filed a complaint in district court alleging that the City, as owner and operator of the Schoharie Reservoir and Shandaken Tunnel, was in violation of 33 U.S.C. § 1311(a), which prohibits "the discharge of any pollutant" unless those discharges are conducted in accordance with a duly issued discharge permit. 33 U.S.C. § 1311(a) (citing permit requirement in 33 U.S.C. § 1342). Catskill alleged that the Tunnel discharges pollutants in the form of "suspended solids," "turbidity," and heat into Esopus Creek. They alleged that the suspended solids and turbidity are the result of

earth-disturbing activities within the Reservoir's watershed that produce fine, red-clay sediments in the Reservoir. They further alleged that the discharges cause the Creek to violate state water quality standards for turbidity and temperature. Esopus Creek, Catskill contended, is naturally clearer and cooler than the water entering it from the Tunnel and supports "one of the premier trout fishing streams in the Catskill Region."

The City responded by moving under Fed.R.Civ.P. 12(b)(1) that the case be dismissed for want of jurisdiction because Catskill's notice-of-intent- to-sue letter ("NOI letter") was inadequate, and a proper NOI letter, they argued, is a jurisdictional prerequisite for a CWA citizen suit. The City also moved pursuant to Fed.R.Civ.P. 12(b)(6) that the case be dismissed because, although the City admits that it lacks a permit to discharge into Esopus Creek, it need not obtain one because its releases do not constitute "discharges" as defined by the CWA.

The district court denied the City's Rule 12(b)(1) motion, concluding that Catskill's NOI letter comported with the requirements of the Act and EPA regulations, but granted the Rule 12(b)(6) motion. It found that, as a matter of law, the Reservoir and Tunnel did not effect an "addition" of a pollutant to the Creek, as required to trigger the CWA's permit requirement. *See* 33 U.S.C. § 1362(12) (defining "discharge of a pollutant" to mean "any addition of any pollutant to navigable waters from any point source"). Catskill appealed.

DISCUSSION

The City makes two arguments in support of the district court's dismissal. It first argues that the district court and this court lack subject matter jurisdiction over the case because Catskill's NOI letter, required by the CWA's citizen suit provision, was inadequate and that a proper NOI letter is a prerequisite to the court's subject-matter jurisdiction. Second, the City reiterates its successful argument in the district court, that the complaint failed to state a claim, because Shandaken Tunnel does not effect an "addition" of a pollutant, as required to constitute a "discharge" for which a permit must be sought.

We agree with the City that the NOI letter did not provide adequate notice of Catskill's eventual claim regarding thermal discharges, but find the letter adequate to notify the City of the balance of Catskill's claims. The district court should have dismissed the thermal discharge claims without prejudice, however, and we therefore vacate the judgment with respect to those claims and remand with direction to dismiss them without prejudice to refiling after submission of a conforming NOI letter and after the 60-day delay required by the CWA. We also conclude that the district court erred in dismissing Catskill's complaint on the theory that Shandaken Tunnel does not "discharge" pollutants into Esopus Creek. We therefore reverse the judgment on the remaining claims and remand the case for further proceedings.

I. The Statutory Framework

We begin with an overview of the regulatory regime. The CWA's primary function is to regulate the discharge of pollutants into navigable waters. Although the Act contains the lofty goal of eliminating water pollutant discharges altogether, *see* 33 U.S.C. § 1251(a)(1), the regulatory regime it creates requires principally that discharges be regulated by permit, not prohibited outright. The Act mandates that "the discharge of any pollutant by any person shall be unlawful," 33 U.S.C. § 1311(a), "[e]xcept as in compliance" with other provisions of the statute, one of which establishes a permitting program, the "National Pollutant Discharge Elimination System" ("NPDES"), 33 U.S.C. § 1342. Section 1342 in turn provides for the issuance of discharge permits ("NPDES permits") that allow the holder to discharge pollutants at levels below thresholds incorporated in the permit. 33 U.S.C. § 1342(a); *see also* 40 C.F.R. § 122.1 et seq. In New York, the NPDES program is administered by NYSDEC and referred to as the State Pollution Discharge Elimination System ("SPDES"). *See* 33 U.S.C. § 1342(b) (authorizing state implementation of the NPDES program); N.Y. Envtl. Conserv. Law §§ 17-0105(13), 17-0701.

In the instant case, Catskill alleges that the City has been violating the CWA's unpermitted discharge prohibition by discharging water containing pollutants from Shandaken Tunnel into Esopus Creek without first obtaining an NPDES permit. The Act defines "discharge of a pollutant" to include "any addition of any pollutant to navigable waters from any point source." 33 U.S.C. § 1362(12). The Act defines "pollutant," "navigable

waters," and "point source," 33 U.S.C. § 1362(6), (7), and (14), but the crux of this appeal is the meaning of "addition," which the Act does not define.

In addition to providing for enforcement by state agencies and the EPA, the CWA allows private parties to enforce its mandates, including the prohibition of unpermitted discharges in § 1311(a), against alleged violators in so- called "citizen suits." *See* 33 U.S.C. § 1365(a)(1), (f). An aggrieved plaintiff may bring a civil action for specific relief, such as the imposition of particular compliance measures, or civil penalties payable to the treasury, *see* 33 U.S.C. § 1365(a), and may recover attorney's fees, *see* 33 U.S.C. § 1365(d). At least 60 days prior to filing, however, the prospective plaintiff must provide notice of its claims to the potential defendant, the EPA, and the state in which the violations allegedly occurred. *See* 33 U.S.C. § 1365(b)(1)(A). If a competent state or federal enforcement agency brings a civil enforcement action against the defendant prior to the citizen complaint's being filed, or an administrative enforcement proceeding prior to the plaintiff's NOI letter, the citizen suit is preempted and must be dismissed. *See* 33 U.S.C. §§ 1319(g)(6), 1365(b)(1)(B).

II. Catskill's Notice of Intent to Sue

The City claims that Catskill's NOI letter was inadequate because, while it was provided in a timely fashion to the proper parties, the letter failed to give the City adequate notice of the claims that Catskill intended to bring. Catskill's complaint as filed alleged discharges of

"a high level of turbidity," "suspended solids," and "elevated temperatures." Yet the NOI letter stated only that the City has discharged "pollutants in the form of Total Suspended Solids and Settleable Solids into the Esopus Creek." The City argues that by failing to provide notice of the claims of turbidity and thermal discharges ultimately alleged in the complaint, the NOI letter was fatally defective, requiring the suit to be dismissed. Although the district court did not rely on this theory in dismissing the complaint, we may affirm on a basis not relied on by the district court. *See Name.Space, Inc. v. Network Solutions, Inc.*, 202 F.3d 573, 584 (2d Cir.2000). We conclude that the NOI letter failed to notify the City of Catskill's thermal discharge claims, but that fact does not invalidate Catskill's complaint in its entirety. Accordingly, we hold that those claims were properly dismissed.

The CWA does not describe the content of the required notice, but directs that "[n]otice . . . shall be given in such manner as the Administrator shall prescribe by regulation." 33 U.S.C. § 1365(b). The EPA has adopted such regulations, which mandate, *inter alia*, as follows:

> Notice regarding an alleged violation of an effluent standard or limitation or of an order with respect thereto, shall include sufficient information to permit the recipient to identify the specific standard, limitation, or order alleged to have been violated, the activity alleged to constitute a violation, the person or persons responsible for the alleged violation, the location of the alleged violation, the date or dates of such violation, and the full name, address, and telephone number of the person giving notice.

40 C.F.R. § 135.3(a). In the past, we have refused to "allow form to prevail over substance" in considering the content required of an NOI letter, and have looked instead to what the particular notice given may reasonably be expected to accomplish. *Dague v. City of Burlington*, 935 F.2d 1343, 1354 (2d Cir.1991), *rev'd in part on other grounds*, 505 U.S. 557, 112 S.Ct. 2638, 120 L.Ed.2d 449 (1992).

The City contends that the EPA regulations require a potential plaintiff to include in an NOI letter each separate pollutant that will be alleged in a subsequent complaint as the basis of a violation of the Act. At least one circuit has adopted such a rule. *See Pub. Interest Research Group v. Hercules*, 50 F.3d 1239, 1248 (3d Cir.1995). On this theory, for example, a plaintiff could not bring suit for discharges of mercury, lead, and copper if the NOI letter alleged violations based only on discharges of copper. In that case, the claims of copper violations would stand, but the claims based on mercury and lead discharges would need to be dismissed. We agree with the City that such a rule logically follows from the regulatory scheme and therefore adopt it.

The EPA regulations require that an NOI letter "include sufficient information to permit the recipient to identify the specific standard, limitation, or order alleged to have been violated, [and] the activity alleged to constitute a violation." 40 C.F.R. § 135.3(a). We believe that to be "sufficient," the information provided must include the pollutant alleged to be the basis of a violation subsequently alleged in the complaint.

Because each discharge of a pollutant represents a distinct violation of the Act, *see* 33 U.S.C. § 1311(a) ("the discharge of any pollutant . . . shall be unlawful"); *Atl. States Legal Found., Inc. v. Tyson Foods, Inc.*, 897 F.2d 1128, 1138 n. 19 (11th Cir.1990), identification in an NOI letter of a pollutant allegedly discharged is essential to provide adequate notice of the alleged violation. Discharges of mercury and lead, for instance, could be distinct violations, each subject to penalties of up to $25,000 per day. *See* 33 U.S.C. §§ 1319(d), 1365(a). To provide adequate notice of each violation that will be targeted in the citizen suit, the NOI letter must differentiate pollutants from nonpollutants and one pollutant from another. The rationale for such a rule is most apparent in the context of a suit alleging discharges in excess of NPDES permit limitations, in which the defendant may be discharging some pollutants lawfully and others unlawfully. To enable the defendant to identify each violation that will be alleged, then, the NOI letter must specify each pollutant unlawfully discharged that will be alleged in a subsequent complaint. The principle applies equally where, as here, the defendant has failed altogether to obtain a permit. To state a claim based on unpermitted discharges, the plaintiff must allege some pollutant that was discharged without a permit. It follows, then, that to the extent the plaintiff intends to prosecute multiple violations involving multiple pollutants, each pollutant that will be the basis of such a claim must be set forth in the NOI letter.

The policies underlying the NOI requirement are furthered by this rule. The notice and 60-day delay requirements allow a potential defendant to identify its own

violations and bring itself into compliance voluntarily, thus making a costly lawsuit unnecessary. *See Hallstrom v. Tillamook County*, 493 U.S. 20, 29-30, 110 S.Ct. 304, 107 L.Ed.2d 237 (1989); *Dague*, 935 F.2d at 1351; *see also Gwaltney of Smithfield, Ltd. v. Chesapeake Bay Found.*, 484 U.S. 49, 108 S.Ct. 376, 98 L.Ed.2d 306 (1987) (holding that if the defendant ceases its violations prior to the filing of the complaint, the action is barred). Specific knowledge of the pollutants allegedly discharged unlawfully makes it easier for the defendant to promptly rectify the problem. *Cf. Atl. States Legal Found., Inc. v. Stroh Die Casting Co.*, 116 F.3d 814, 819-20 (7th Cir.1997) ("In practical terms, the notice must be sufficiently specific to inform the alleged violator about what it is doing wrong, so that it will know what corrective actions will avert a lawsuit. . . . The key to notice is to give the accused company the opportunity to correct the problem.").

The notice and delay requirements are also designed to allow the enforcer of first resort, the EPA or the appropriate state agency, to bring its own enforcement action, *see Hallstrom*, 493 U.S. at 29, which would preempt the citizen lawsuit, *see* 33 U.S.C. § 1365(b)(1)(B). Inclusion of each pollutant forming the basis of an alleged violation better allows enforcement agencies to identify and prosecute a potential defendant's violations, giving effect to Congress's intention that citizen enforcers supplement, not supplant, public enforcement. *See id.* (citing *Gwaltney*, 484 U.S. at 60).

Accordingly, we hold that an NOI letter must identify with reasonable specificity each pollutant that the defendant is alleged to have discharged unlawfully. Failure to

do so will justify a district court's dismissing claims based on pollutants not properly noticed.

Turning to the case at hand, we conclude that Catskill's NOI letter adequately notified the City of some but not all of the violations subsequently alleged in the complaint. The district court found, and Catskill argues on appeal, that inclusion of "suspended solids" and "settleable solids" was sufficient to notify the City of Catskill's claims of turbidity and thermal discharges, because of the logical and empirical associations between suspended solids on the one hand and turbidity and thermal discharges on the other. We agree with respect to Catskill's claims of turbidity discharges, but not with respect to thermal discharges.

Turbid water, by definition, is water carrying high levels of solids in suspension. The presence of elevated levels of suspended solids inevitably produces turbidity. "Turbid" is defined as "having the lees or sediment disturbed: thick or opaque with matter in suspension." *Webster's Third New International Dictionary* 2464 (1981). Water cannot be turbid without suspended solids, and some level of turbidity is inherent where suspended solids are present. Because each logically depends on the other, notice of discharges of suspended solids is sufficient to notify of an eventual claim based on discharges of "turbidity."

On the other hand, the relationship between suspended solids and temperature is one of association, not identity. To be sure, increased turbidity often produces increased water temperature. Particles suspended in water absorb heat, raising the temperature of the water.

But the presence of suspended solids does not inevitably raise water temperature. The effect of suspended solids on temperature depends on a third variable, radiant heat, usually in the form of sunlight. Increased turbidity in a cold, dark place may not affect the temperature of the water at all, or may do so only infinitesimally, because no source of radiant heat is present. As a result, unlike suspended solids and turbidity, there is no necessary relationship between suspended solids and increased temperature. The relationship is only one of frequent association under ordinary circumstances.

Accordingly, to be sufficient, the allegations in an NOI letter must suggest that these ordinary circumstances were also prevalent. Where alleged circumstances indicate that suspended solids and increased temperature are very likely to be associated, notice of suspended solids may be sufficient to notify a reasonable person of a thermal discharge claim. In the instant case, Catskill's NOI letter does not state that such circumstances were prevalent.

For the foregoing reasons, we hold that Catskill's claims of unpermitted thermal discharges were properly dismissed under Rule 12(b)(6). However, those claims should have been dismissed without prejudice. Thus we vacate so much of the judgment as dismissed Catskill's thermal discharge claims with prejudice and remand those claims with direction that they be dismissed without prejudice to refiling after full compliance with 33 U.S.C. § 1365(b)(1)(A).

III. Interbasin Transfer as a "Release" Under the CWA

As we have noted, the CWA prohibits, unless otherwise allowed by permit, "the discharge of any pollutant," 33 U.S.C. § 1311(a), which the Act defines to mean "any addition of any pollutant to navigable waters from any point source," 33 U.S.C. § 1362(12). The statute does not define "addition." The City argues that the release of water from Schoharie Reservoir into Esopus Creek is not an "addition," citing *National Wildlife Federation v. Gorsuch*, 693 F.2d 156 (D.C.Cir.1982), and *National Wildlife Federation v. Consumers Power Co.*, 862 F.2d 580 (6th Cir.1988), both of which accorded substantial deference to the EPA's position that the CWA's discharge permit requirement does not apply to discharges from dams. Catskill counters that the *Gorsuch* and *Consumers Power* courts accorded unjustified deference to the EPA's interpretation of "addition," that the cases are distinguishable on their facts, and that the City's conduct here qualifies as an "addition" under the plain meaning of that word. We agree with Catskill and accordingly reverse the district court and remand for further proceedings on Catskill's remaining claims.

A. The EPA's Position and the Proper Standard of Deference

In several policy statements made in opinion letters and reports to Congress in the 1970s and 1980s, the EPA took the position that dam releases should not be considered "discharges" under the CWA and thus NPDES

permits would not be required for those releases.[2] *See Gorsuch*, 693 F.2d at 167-69. This position was never formalized in a notice-and-comment rulemaking or formal adjudication under the Administrative Procedure Act, 5 U.S.C. §§ 553, 554, although the EPA subsequently reiterated its position in the *Gorsuch* and *Consumers Power* cases, as a defendant and amicus curiae, respectively. *See Consumers Power*, 862 F.2d at 583; *Gorsuch*, 693 F.2d at 165. Both courts rested their decisions on the conclusion that the EPA position deserved substantial deference and was reasonable. Given subsequent Supreme Court decisions governing judicial deference to federal agencies' constructions of the statutes that they implement, we hold that the EPA position is due less deference than that accorded it by the *Gorsuch* and *Consumers Power* courts.

In 1982, in *Gorsuch*, the District of Columbia Circuit deferred to the EPA's position that dam releases were not "additions" under the CWA, which it upheld as a reasonable construction of the statute. The *Gorsuch* plaintiffs had sued the EPA under 33 U.S.C. § 1365(a)(2), seeking a declaration that the EPA had a nondiscretionary duty to require NPDES permits from dam operators. After an extensive exegesis of the CWA's statutory text, structure, and legislative history, the court concluded that the EPA could reasonably conclude that dam releases were not

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[2] The original documents in which the EPA staked out its position were not included in the filings before this court and were not published in the usual sources of administrative law, the *Code of Federal Regulations* and the *Federal Register*. We accordingly base our discussion of the EPA's position on that included in the District of Columbia Circuit's comprehensive opinion in *Gorsuch*.

"additions." *See* 693 F.2d at 170-83. Notwithstanding the court's extensive investigation of legislative intent, its relied ultimately on deference to the agency:

> [W]e emphasize the narrowness of our decision. It is not our function to decide whether EPA's interpretation . . . is the best one or even whether it is more reasonable than the Wildlife Federation's interpretation. We hold merely that EPA's interpretation is reasonable, not inconsistent with congressional intent, and entitled to great deference; therefore, it must be upheld.

693 F.2d at 183. In 1988, the Sixth Circuit reached the same conclusion. *See Consumers Power*, 862 F.2d at 584-87.

If the EPA's position had been adopted in a rulemaking or other formal proceeding, deference of the sort applied by the *Gorsuch* and *Consumers Power* courts might be appropriate. Instead, the EPA's position is based on a series of informal policy statements made and consistent litigation positions taken by the EPA over the years, primarily in the 1970s and 1980s. Recent Supreme Court cases emphasize that such agency statements do not deserve broad deference of the sort accorded by the *Gorsuch* and *Consumers Power* courts.[3] *See United States v. Mead Corp.*, ___ U.S. ___, 121 S.Ct. 2164, 150 L.Ed.2d 292 (2001); *Christensen v. Harris County*, 529 U.S. 576, 120 S.Ct. 1655, 146 L.Ed.2d 621 (2000). In *Christensen*, the Supreme

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[3] *Consumers Power* expressly applied the standard of deference elaborated in *Chevron U.S.A. Inc. v. Natural Resources Defense Council*, 467 U.S. 837, 104 S.Ct. 2778, 81 L.Ed.2d 694 (1984). *See* 862 F.2d at 584-85. *Gorsuch*, which predated *Chevron*, applied essentially the same degree of deference. *See* 693 F.2d at 166-67.

Court held that "[i]nterpretations such as those in opinion letters – like interpretations contained in policy statements, agency manuals, and enforcement guidelines, all of which lack the force of law – do not warrant *Chevron*-style deference." 529 U.S. at 587. "Instead," the Court continued, "interpretations contained in formats such as opinion letters are 'entitled to respect' . . . but only to the extent that those interpretations have the 'power to persuade.' " *Id.* (citation omitted). The Court consequently held that an opinion letter by the Department of Labor deserved only this form of limited deference in its interpretation of a provision of the Fair Labor Standards Act. *See id.*

Like the position taken by the Department of Labor in its opinion letter in *Christensen*, the EPA position on dam discharges has never been articulated in circumstances that would give it the "force of law." *Gorsuch* describes only a series of letters and several presentations for Congress in reports and testimony that outlined the EPA's position. *See Gorsuch*, 693 F.2d at 167-69. None of these sources come close to the sort of formal, binding articulation of an agency's views that would justify *Chevron* deference after *Christensen*. That the EPA later relied on its position in litigation does not alter our analysis; a position adopted in the course of litigation lacks the indicia of expertise, regularity, rigorous consideration, and public scrutiny that justify *Chevron* deference. *See Bowen v. Georgetown Univ. Hosp.*, 488 U.S. 204, 212, 109 S.Ct. 468, 102 L.Ed.2d 493 (1988); *Ball v. Memphis Bar-B-Q Co.*, 228 F.3d 360, 365 (4th Cir.2000); *S. Utah Wilderness Alliance v. Dabney*, 222 F.3d 819, 828 (10th Cir.2000).

However, as *Mead* and *Christensen* make clear, courts do not face a choice between *Chevron* deference and no deference at all. Administrative decisions not subject to *Chevron* deference may be entitled to a lesser degree of deference: the agency position should be followed to the extent persuasive. *See Mead*, ___ U.S. at ___ - ___, 121 S.Ct. at 2175-76 (citing *Skidmore v. Swift & Co.*, 323 U.S. 134, 140, 65 S.Ct. 161, 89 L.Ed. 124 (1944)). For the reasons that follow, however, we do not find the EPA's position to be persuasive.

B. Defining "Addition"

The EPA's position, upheld by the *Gorsuch* and *Consumers Power* courts, is that for there to be an "addition," a "point source must *introduce* the pollutant into navigable water from the outside world." *Gorsuch*, 693 F.2d at 165. We agree with this view provided that "outside world" is construed as any place outside the particular water body to which pollutants are introduced. Given that understanding of "addition," the transfer of water containing pollutants from one body of water to another, distinct body of water is plainly an addition and thus a "discharge" that demands an NPDES permit.

Both *Gorsuch* and *Consumers Power* essentially involved the recirculation of water, without anything added "from the outside world." Such recirculation, they concluded, could not be an "addition." In *Gorsuch*, water was released from a reservoir through a dam to the stream below. Plaintiffs complained that such a release amounted to a regulated discharge under the Act, requiring a permit. The reservoir above the dam and the stream

below, at least arguably, were sufficiently the "same" water that the release might not be considered an "addition"; nothing was introduced to the water that was not, in some sense, already there. *See* 693 F.2d at 174-75.

In *Consumers Power,* the defendant had withdrawn water from Lake Michigan, along with some surprised fish, for hydroelectric power generation. The water and fish were then returned to the Lake after passing through hydroelectric generators, which pureed some of the fish. The court found that returning the fish to the Lake, albeit in a different form, was not an "addition" because the fish had already been there. *See* 862 F.2d at 586. Indeed, the court concluded that "[t]he water which passes through the [defendant's hydropower works] never loses its status as water of the United States." *Id.* at 589. The navigable water was recirculated, but nothing was added. The Sixth Circuit therefore also concluded that the releases from the defendant's hydropower works were not "introduced from the outside world." *See id.* at 586. Beyond *Consumers Power,* several cases from other circuits, despite having found "additions" to have occurred, in dicta reiterated the *Gorsuch* holding. *See, e.g., Comm. to Save Mokelumne River v. E. Bay Mun. Util. Dist.,* 13 F.3d 305, 308-09 (9th Cir.1993); *United States v. Law,* 979 F.2d 977, 979 (4th Cir.1992) ("Where 'pollutants' exist[ ] *in the waters of the United States* before contact with these facilities, the mere diversion in the flow of the waters [does] not constitute 'additions' of pollutants to the water.").

The *Gorsuch* and *Consumers Power* decisions comport with the plain meaning of "addition," assuming that the water from which the discharges came is the same as that

to which they go.[4] If one takes a ladle of soup from a pot, lifts it above the pot, and pours it back into the pot, one has not "added" soup or anything else to the pot (beyond, perhaps, a *de minimis* quantity of airborne dust that fell into the ladle). In requiring a permit for such a "discharge," the EPA might as easily require a permit for Niagra Falls.

The present case, however, strains past the breaking point the assumption of "sameness" made by the *Gorsuch* and *Consumers Power* courts. Here, water is artificially diverted from its natural course and travels several miles from the Reservoir through Shandaken Tunnel to Esopus Creek, a body of water utterly unrelated in any relevant sense to the Schoharie Reservoir and its watershed. No one can reasonably argue that the water in the Reservoir and the Esopus are in any sense the "same," such that "addition" of one to the other is a logical impossibility. When the water and the suspended sediment therein passes from the Tunnel into the Creek, an "addition" of a "pollutant" from a "point source" has been made to a "navigable water," and the terms of the statute are satisfied.

In *Dague v. City of Burlington*, 935 F.2d 1343 (2d Cir.1991), we implicitly held the release of polluted water from one water body to a distinct, less-polluted water body to be an addition of pollutants to the latter. We

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[4] We need not and do not decide whether those courts were correct in accepting that the source and destination waters were identical and thus whether we would reach their conclusions if presented with the same facts.

concluded that a "discharge" had occurred where leachate from a landfill entered a pond and thereafter water from the pond, polluted with the leachate, flowed through a culvert into a surrounding marsh. We held that (1) the pond and marsh were different navigable waters; (2) the culvert was the relevant point source; and (3) the release of pond water through the culvert was a "discharge." We thus necessarily implied that the transfer of water from the pond to the marsh was an "addition." *Id.* at 1354-55. We also expressly rejected the defendant's argument that the water flowing from pond to marsh was not an "addition," noting that "[u]nder this argument, pollutants would be 'added' only when they are introduced into navigable waters for the first time." *Id.* at 1354.

The First Circuit reached a similar conclusion in *Dubois v. U.S. Dep't of Agriculture,* 102 F.3d 1273 (1st Cir.1996). In that case, a ski resort operator on Department of Agriculture property pumped water without a permit from a polluted river into a less-polluted pond to operate its snowmaking equipment. The court held that the transfer of polluted water from one water body to a distinct water body constitutes an "addition" of pollutants to the destination water body. The court emphasized that the two bodies of water, for all relevant purposes, were distinct: although water naturally flowed from the pond into the river, water would never naturally flow from river to pond. That difference made the pumping an "addition." *See id.* at 1296-97. The court distinguished *Gorsuch* and *Consumers Power* as involving movement of water within the same water body. *See id.* at 1299.

The City also argues that "addition" draws meaning from its association with the phrase "from a point source." This view misunderstands the import of the term "point source," which does not necessarily refer to the place where the pollutant was created but rather refers only the proximate source from which the pollutant is directly introduced to the destination water body. A pipe from a factory draining effluent into a navigable water is a point source, but the factory itself is not. This is clear from the text of the Act, which defines "point source," in relevant part, as

> any discernible, confined and discrete conveyance, including but not limited to any pipe, ditch, channel, tunnel, conduit, well, discrete fissure, container, rolling stock, concentrated animal feeding operation, or vessel or other floating craft, from which pollutants are or may be discharged.

33 U.S.C. § 1362(14). Under most circumstances, a "pipe, ditch, channel, tunnel, [or] conduit" is unlikely to have created the pollutants that it releases, but rather transports them from their original source to the destination water body.

As a "tunnel," Shandaken Tunnel plainly qualifies as a point source. The tunnel itself need not have created the pollution; it is enough that it conveys the pollutants from their original source to the navigable water. *See United States v. Plaza Health Labs., Inc.*, 3 F.3d 643, 646 (2d Cir.1993). The City's proposed interpretation of "from a point source" is inconsistent with the CWA's definition of a point source.

Given the ordinary meaning of the CWA's text and our holding in *Dague*, we cannot accept the *Gorsuch* and *Consumers Power* courts' understanding of "addition," at least insofar as it implies acceptance of what the *Dubois* court called a "singular entity" theory of navigable waters, in which an addition to one water body is deemed an addition to all of the waters of the United States. *See Dubois*, 102 F.3d at 1296-97. We properly rejected that approach in *Dague*. Such a theory would mean that movement of water from one discrete water body to another would not be an addition even if it involved a transfer of water from a water body contaminated with myriad pollutants to a pristine water body containing few or no pollutants. Such an interpretation is inconsistent with the ordinary meaning of the word "addition."

Even if we were to conclude that the proper application of the statutory text to the present facts was sufficiently ambiguous to justify reliance on the legislative history of the statute, *see Blum v. Stenson*, 465 U.S. 886, 896, 104 S.Ct. 1541, 79 L.Ed.2d 891 (1984), that source of legislative intent would not help the City. The legislative history is silent on the meaning of "addition." *See Gorsuch*, 693 F.2d at 175. Instead, the City relies principally on evidence from other provisions of the statute that Congress sought (1) to target industrial and municipal wastes specifically, *see Plaza Health Labs.*, 3 F.3d at 647, and (2) to leave the regulation of water supply – and therefore dam and reservoir operations – to the states, *see* 33 U.S.C. § 1251(g) ("It is the policy of Congress that the authority of each State to allocate quantities of water

within its jurisdiction shall not be superseded, abrogated, or otherwise impaired by this [Act].").

Yet like many complex statutes (and the CWA is among the most complex), the CWA balances a welter of consistent and inconsistent goals. In contrast with the policies cited by the City, the CWA also expressly includes a broad and uncompromising policy of "restor[ing] and maintain[ing] the chemical, physical, and biological integrity of the Nation's waters." 33 U.S.C. § 1251(a). Artificially transferring water and pollutants between watersheds as the City has done here might well interfere with that integrity, as Catskill has alleged. Moreover, in the past we have applied the Act's proscriptions beyond industrial discharges. *See Concerned Area Residents for the Env't v. Southview Farm*, 34 F.3d 114 (2d Cir.1994) (involving discharges of agricultural waste).

In any event, none of the statute's broad purposes sways us from what we find to be the plain meaning of its text. *Cf. Plaza Health Labs.*, 3 F.3d at 647 ("The narrow questions posed by this case . . . may not be resolved merely by simple reference to [the CWA's] admirable goal[s]."). Where a statute seeks to balance competing policies, congressional intent is not served by elevating one policy above the others, particularly where the balance struck in the text is sufficiently clear to point to an answer. We find that the textual requirements of the discharge prohibition in § 1311(a) and the definition of "discharge of a pollutant" in § 1362(12) are met here.

CONCLUSION

The judgment of the district court is hereby reversed in part, vacated in part, and the case is remanded. We vacate so much of the judgment as dismissed Catskill's thermal discharge claims and remand with direction that those claims be dismissed without prejudice to refiling after full compliance with 33 U.S.C. § 1365(b)(1)(A). The remainder of the judgment dismissing the complaint is reversed and remanded for further proceedings consistent with this opinion. Costs are awarded to appellants.